95-1086

Supreme Court, U.S.
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No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1995

EMILY DISTAJO, et al.,

Petitioners,

v.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

Petition for a Writ of Certiorari
to the United States Court of
Appeals for the Second Circuit

PETITION FOR A WRIT OF CERTIORARI

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January 2, 1996

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QUESTIONS PRESENTED FOR REVIEW

(1) Whether 9 U.S.C. § 4 confers subject matter jurisdiction of petitions to compel arbitration upon United States District Courts which do not, and could not, have subject matter jurisdiction of the underlying state court lawsuits raising the issues to be arbitrated.

(2) Whether Illinois law permits relitigation of the enforceability and validity of the arbitration clauses while post-trial motions and/or appeals are pending from the prior nine Illinois trial court final judgments holding the arbitration clauses void and unenforceable.

(3) Whether North Carolina law permits relitigation of the enforceability and validity of the arbitration clause while DAI appeals the prior North Carolina state trial court orders denying DAI's motion to stay

under 9 U.S.C. § 3 and denying DAI's motion to dismiss based upon the contention that the arbitration clause required arbitration as a condition precedent to litigation.

(4) Whether the rule of *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) required the Federal Courts to abstain from exercising subject matter jurisdiction of the petitions to compel arbitration, in view of the prior nine Illinois, one Alabama, and one North Carolina state trial court judgments holding the arbitration clauses void and unenforceable.

PARTIES TO PROCEEDINGS

The parties to Case Numbers 94-9207, 94-9293 and 94-9209 in the United States Court of Appeals for the Second Circuit were Emily Distajo, Renato, Distajo, Constantino Lamando, Milo Lamando, Jose Alberto Brenes, Alvaro Guerrero, Maria T. Guerrero, Wesam S. Youmaran, Linda Youmaran, Julie Shino, Johnson Shino, Albert Yonan, Leylah Yonan, Louise Loenneke, Mary Ann Bookout, Michael Johnson, Deborah A. Kane, Gregory F. Kane, Bruno Gianinni, Ronald Rothmund, Patricia Rothmund, John S. Papaleo, J.S.P., Inc., John A. McCrary, John Gillon, Sonya Smith, Paul Riise, Melissa Riise, and Rhonda Benton as Defendants-Appellants and Doctor's Associates, Inc. as Plaintiff-Appellee. The parties to Case Number 95-7183 in the United States Court of Appeals for the Second Circuit were Sandra Bickel

and Raymond Bickel, Defendants-Appellants and Doctor's Associates, Inc., Plaintiff-Appellee.

One opinion was issued by the Second Circuit Court of Appeals for all four appeals.

J.S.P., Inc. is a closely held corporation which is not publicly traded and has no subsidiaries, parent corporations or affiliates and is owned by John S. Papaleo, one of the petitioners.

Doctor's Associates, Inc. is not publicly traded and is owned by Frederick DeLuca and Peter S. Buck who are each 50 percent shareholders. Doctor's Associates, Inc. is a Subchapter S corporation. Petitioners are not aware of any subsidiaries of Doctor's Associates, Inc. Affiliated corporations also owned by Frederick DeLuca and Peter Buck include Subway

Sandwich Shops, Inc., Subway Restaurants, Inc., Subway Real Estate Corp., Franchise Real Estate Leasing Corporation, Franchise World Headquarters, Inc., National Company Stores, Inc., Subway Central, Inc., Subway West, Inc., Subway South, Inc., Subway East, Inc., Subway Management, Inc., Subway Development of America, Inc., Subway Leasing Corp., Inc., Subway Real Estate Development, Inc., National Franchise Realty, Inc., Subway Restaurants of California, Inc., Subway Sandwiches, Inc., Subway Sandwiches & Salads, Inc., and Subway Equipment Leasing Company, Inc. To the understanding of Petitioners, all of these companies are owned by Frederick DeLuca and Peter Buck.

Petitioners are not aware of any other subsidiaries, parent companies, affiliates or shareholders which are

required to be listed pursuant to Rule 29.01.

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Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

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PETITION FOR A WRIT OF CERTIORARI

Emily Distajo, et al., respectfully petition for a writ of certiorari to review the judgment and order of the Second Circuit entered on September 12, 1995, as amended on September 28, 1995, and the orders of November 1, 1995 and November 14, 1995 denying the petitions for rehearing

OPINIONS BELOW

The September 12, 1995 judgment of the Second Circuit is reported at *Doctor's Associates, Inc. v. Distajo*, 66 F.3d 438 (2nd Cir. 1995) and is reprinted in the appendix.

JURISDICTION

This Court has jurisdiction to review the judgment of the Second Circuit under 28 U.S.C. § 1254(1).

Petitioners submit that the District Court did not have subject matter jurisdiction under 9 U.S.C. § 4.

The Second Circuit had jurisdiction to review the judgments of the District Court under 28 U.S.C. § 1291, 28 U.S.C. § 16(a)(3) and 28 U.S.C. § 1292(a)(1).

STATUTORY PROVISIONS INVOLVED

9 U.S.C. §§ 3 and 4, 28 U.S.C. § 1738, 735 ILCS § 5/2-619(a)(3), Illinois Supreme Court Rules 20(a) and (b), 304(a) and 272, all of which are set

forth in the appendix.

STATEMENT OF THE CASE

Doctor's Associates, Inc. (hereinafter "DAI") is the national franchisor for Subway Sandwich Shops. Its standard franchise agreements provide that both it and the franchisee will arbitrate all disputes in Connecticut and that arbitration is a condition precedent to litigation. DAI also requires each franchisee to sign a sublease with a leasing company. Each leasing company enters into a master lease with the landlord for each location. The rent due under the sublease is the same as the rent due under the master lease and the franchisees pay rent directly to the landlord.

Each sublease contains a "cross-default" clause which provides that a default in the terms of the franchise

agreement by the franchisee, sub-tenant is a breach of the sublease.

The leasing companies have no employees, no income, no assets, file no income tax returns and have been held to be the alter-egos of DAI in several cases.

DAI uses its alter-ego leasing companies to resolve its claims against the franchisees by filing eviction lawsuits, in the names of the leasing companies, under the terms of the "cross-default" provision in the subleases. At the same time DAI requires the franchisees to resolve their related claims against DAI by arbitration in Connecticut. The subleases do not have arbitration clauses.

The 17 groups of franchisees-defendants filed, respectively, 17 state court lawsuits against DAI, its leasing

companies, development agents and owners. Nine such state court lawsuits were filed in Illinois, 5 in Alabama, 1 in North Carolina, 1 in Massachusetts and one in Pennsylvania. The franchisees claimed, in their state court lawsuits, that the arbitration clauses were void and unenforceable because the agreements lacked mutuality, because DAI waived its right to arbitrate by proceeding through its alter-ego leasing companies, because DAI fraudulently induced the franchisees into the arbitration agreement by representing that arbitration was a condition precedent to litigation by both parties and because the arbitration agreements were unconscionable and did not meet the reasonable expectations of the parties.

Eleven of the state courts (all of the state courts that considered the

issue) entered judgments in favor of the franchisees holding the arbitration clauses void and unenforceable for one or more of these reasons.

The state court lawsuits claimed damages for breach of contract, fraud, violation of the state consumer protection statutes and violation of the state Franchise Disclosure Acts.

After the franchisees filed their state court lawsuits, DAI filed 17 petitions to compel arbitration in the Federal Court for Connecticut and sought preliminary injunctions to enjoin the franchisees from prosecuting their state court lawsuits.

The franchisees joined the development agents as defendants in each of the 17 state court lawsuits. The development agents, in each case, were citizens of the same states as the franchisee plaintiffs. The state court

lawsuits did not assert claims under any Federal statutes. There was neither Federal question nor Federal diversity jurisdiction of the state court lawsuits.

In the Connecticut District Court the franchisees each contended that the District Court lacked subject matter jurisdiction under 9 U.S.C. § 4, that the prior 11 state court judgments holding the arbitration clauses void and unenforceable were binding on the Federal Court under the Full Faith and Credit Statute, 28 U.S.C. § 1738, and that the Federal Court should abstain from exercising jurisdiction.

On November 10, 1994, the District Court entered orders compelling all 17 groups of franchisees to arbitrate their claims against DAI in Connecticut. The District Court then entered temporary restraining orders and preliminary

injunctions against the franchisees barring them from prosecuting their 17 state court lawsuits.

The 17 groups of franchisees appealed.

On September 12, 1995, the Second Circuit issued its opinion reversing the District Court on all 17 orders compelling arbitration and all 17 preliminary injunctions and remanded the cases to the District Court to consider the franchisees' fraud, waiver and alter-ego defenses to arbitration. The Petitioners' petitions for rehearing were denied on November 1 and November 14, 1995.

REASONS FOR GRANTING THE WRIT

(1) The Court should grant the Petition to clarify that 9 U.S.C. § 4 does not grant subject matter jurisdiction to the United States District Courts to compel arbitration of

issues raised in underlying state court lawsuits of which the Federal District Courts could not, and do not, have subject matter jurisdiction.

The District Court ordered the 17 groups of franchisees to arbitrate their damage claims against DAI. These damage claims are set forth in the underlying state court lawsuits. It is undisputed that the Federal Courts do not, and could not, have subject matter jurisdiction of those underlying claims.

The Federal Arbitration Act, 9 U.S.C. § 1 *et seq*. does not create any independent Federal question jurisdiction under 28 U.S.C. § 1331. 9 U.S.C. § 4 provides for an order compelling arbitration only when the Federal District Court would have jurisdiction over a suit on the underlying dispute. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*,

460 U.S. 1, 25n. 32, 103 S.Ct. 927, 941n. 32, 74 L.Ed. 2d 765 (1983).

9 U.S.C. § 3 provides that a motion to stay litigation pending arbitration may be filed only in the lawsuit sought to be stayed. In the cases at bar, such motions could have been filed only in the underlying 17 state court lawsuits. On the other hand, petitions to compel arbitration under 9 U.S.C. § 4 may be filed wherever jurisdiction and venue are proper. The net result of successful actions under 9 U.S.C. §§ 3 and 4 are the same. The existing lawsuit (if one has been filed) is stayed pending arbitration.

In *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 26 n.35, 103 S.Ct. 927, 74 L.Ed.2d 765 (1983), this Court noted that at least one court has held that state courts may grant orders compelling arbitration

under 9 U.S.C. § 4, citing *Maine v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 67 Cal.App.3d 19, 24-25, 136 Cal. Rptr. 378, 380-381 (Cal. App. 1977).

DAI filed petitions to stay 5 of the first 6 Illinois state court lawsuits under 9 U.S.C. § 3, then withdrew those motions before the state court could rule.

DAI thus abandoned all efforts to litigate the enforceability and validity of the arbitration clauses in the state court actions under 9 U.S.C. § 3 in favor of litigating those issues in the Federal Court in Connecticut under 9 U.S.C. § 4.

Enforcement of the Federal Arbitration Act is left to the state courts in most cases. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 25 n.32, 103 S.Ct. 927, 941 n.32, 74 L.Ed. 2d 765 (1983).

9 U.S.C. § 4 provides:

> "A party aggrieved by the failure *** of another to arbitrate under a written agreement for arbitration may petition any United States District Court which, save for such agreement, would have jurisdiction under Title 28, in a civil action *** of the subject matter of a suit arising out of the controversy between the parties ***" (*Emphasis added*).

Petitioners submit that 9 U.S.C. §§ 3 and 4 must be read together and further submit that Congress did not intend to confer subject matter jurisdiction of petitions to compel arbitration upon Federal District Courts which could not have jurisdiction of the underlying lawsuits raising the issues to be arbitrated. Petitioners submit that 9 U.S.C. § 1, *et seq.*, was not intended to change the rules governing jurisdiction. Instead, the intent of the Federal Arbitration Act was to enforce arbitration agreements according

to their terms by either the state or Federal Courts which otherwise have jurisdiction of the underlying claims.

In *Prudential-Bache Securities, Inc. v. Fitch*, 966 F.2d 981, 988 (5th Cir. 1992), the Court recognized that 9 U.S.C. § 4 appears to condition Federal court jurisdiction of petitions to compel arbitration upon Federal Court jurisdiction of the underlying dispute. The Court, however, avoided the issue presented here by holding that the claimed Federal question jurisdiction raised in the related state court lawsuit was not before the Court which based its decision strictly upon the allegations of the complaint to compel arbitration.

Petitioners' position is based upon the text of 9 U.S.C. § 4 upon which DAI relies for subject matter jurisdiction. Petitioners' position is not based upon

the joinder or non-joinder of the non-diverse state court parties to the Federal court petitions to compel arbitration.

The Second Circuit analyzed the subject matter jurisdiction issue primarily on the grounds that the non-diverse development agents were not indispensable parties to the petitions to compel arbitration under F.R.C.P. 19(a) and (b). See the Appendix at pages 15a and 16a.

Petitioners respectfully submit that Congress did not intend for the Federal Arbitration Act to extend the scope of Federal Court jurisdiction but, instead, intended for the Federal Arbitration Act to be enforced by the state and Federal Courts in accordance with existing jurisdictional rules.

(2) The Court should grant the Petition to resolve the conflict between

the Second Circuit and the Illinois Supreme Court on the issue of whether the prior nine Illinois state court judgments, holding the arbitration clauses void and unenforceable, would be given preclusive effect by the Illinois State Courts, thereby entitling those prior judgments to full faith and credit in the Federal Courts.

The Second Circuit misapprehended or overlooked the Petitioners' arguments that *Harding Company v. Harding*, 352 Ill. 417, 426 [4], 186 N.E. 152 (Ill. 1933) established that the doctrine of *res judicata* prohibits the parties to a final trial court judgment from relitigating that issue, except by appeal, and that this rule of law was not overruled or reversed by the Illinois Supreme Court opinions in *Relph v. Board of Education*, 84 Ill.2d 436, 420 N.E.2d 1947 (Ill. 1981) and *Ballweg*

v. City of Springfield, 114 Ill.2d 107, 499 N.E.2d 1373 (Ill. 1986) which are factually distinguishable.

Harding Company v. Harding was just cited with approval by the Illinois Supreme Court on a collateral estoppel issue in *Herzog v. Lexington Township*, Ill. S.Ct. No. 77037, slip opinion issued on October 19, 1995, at page 4.

The Second Circuit also overlooked Petitioners contention that an Illinois statute, which requires dismissal of a second lawsuit raising the same claims between the same parties, gave preclusive effect to the 9 prior Illinois trial court judgments. *See* 735 ILCS § 5/2-619(a)(3). The Second Circuit did not address that argument. The Second Circuit also did not refer to *Harding Company v. Harding* in its opinion. *See* the Appendix at 26a.

The Illinois trial court judgments

were entered under Illinois Supreme Court Rules 272 and 304(a) which specifically provide that the trial court judgments are final, appealable judgments. Those two rules and the holding in *Relph v. Board of Education*, 84 Ill.2d 436, 420 N.E.2d 1947 (Ill. 1981) establish that an Illinois trial court's judgment becomes final for purposes of *res judicata* and appeal at the same time.

This principle was reaffirmed by the Illinois Supreme Court in *In re Marriage of Verdung*, 126 Ill.2d 542, 535 N.E.2d 818, 823 [7] (Ill. 1989), three years after the opinion in *Ballweg v. City of Springfield*.

The Second Circuit also overlooked Illinois appellate court opinions which provide that lawsuits raising issues previously decided in prior litigation between the same or related parties

should be stayed when the prior decisions are the subject of appeal, until the issue is decided in the first appeal. *Wiseman v. Law Research, Inc.*, 270 N.E.2d 77, 80 (Ill. App. 1981) and *Illinois Founders Ins. Co. v. Guidish*, 248 Ill.App.3d 116, 120, 618 N.E.2d 436 (Ill. App. 1993). Those opinions are consistent with and not in conflict with the Illinois Supreme Court decisions in *Relph v. Board of Education* and *Ballweg v. City of Springfield*.

The Second Circuit acknowledged the conflict in the Illinois decisions. The Second Circuit, however, could not certify the questions of Illinois state law to the Illinois Supreme Court. The Illinois Supreme Court will accept certification of questions of state law only from the Seventh Circuit or the United States Supreme Court. Illinois Supreme Court Rule 20(a).

In addition to the 11 state trial court judgments at issue here, the Illinois courts have previously held that DAI waives its right to arbitrate by filing eviction lawsuits in the name of its alter-ego and/or agent leasing companies. *Yates v. Doctor's Associates, Inc.*, 193 Ill.App.3d 431, 549 N.E.2d 1010 (Ill. App. 1990). Illinois courts have also previously approved the award of punitive damages against DAI, in favor of a franchisee, on the grounds, among others, that this method of resolving disputes constitutes a fraud on the franchisee. *Cox v. Doctor's Associates, Inc.*, 245 Ill.App.3d 186, 613 N.E.2d 1306 (Ill. App. 1993), petition for leave to appeal denied, 152 Ill.2d 556 (1993), cert. denied 114 S.Ct. 1069 (1994).

In *Allen v. McCurry*, 449 U.S. 90, 95 [6], 101 S.Ct. 411, 66 L.Ed.2d 308

(1980), the United States Supreme Court stated:

> "[6] The federal courts generally have also consistently accorded preclusive effect to issues decided by state courts. *E.g., Montana v. United States, supra; Angel v. Bullington*, 330 U.S. 183, 67 S.Ct. 657, 91 L.Ed. 832. Thus, *res judicata* and collateral estoppel not only reduce unnecessary litigation and foster reliance on adjudication, but also promote the comity between state and federal courts that has been recognized as a bulwark of the federal system. See *Young v. Harris*, 401 U.S. 37, 43-45, 91 S.Ct. 746, 750-751, 27 L.Ed.

669."

At the very least, the Illinois Supreme Court should be given the opportunity to clarify whether the prior Illinois judgments would or would not have preclusive effect under Illinois law, thereby requiring the Federal Courts to give full faith and credit to such prior state court judgments under the Full Faith and Credit Statute, 28 U.S.C. § 1738.

(3) The Court should grant the Petition to resolve the conflict between the Second Circuit and the North Carolina Supreme Court on the issue of whether the prior North Carolina state trial court decision, holding the arbitration clause void and unenforceable, would be given preclusive effect by the North Carolina state courts, thereby entitling that prior judgment to full faith and credit in the

Federal Courts.

Under North Carolina law it is clear that when a fact has been agreed upon or decided in a court of record, neither of the parties shall be allowed to call it into question, and have it tried over again at any time thereafter so long as the judgment or decree stands unreversed. *King v. Grindstaff*, 284 N.C. 348, 200 S.E.2d 799, 804 (N.C. 1973), *Bryant v. Shields*, 220 N.C. 628, 18 S.E.2d 157 (N.C. 1942), *McInnis & Associates, Inc. v. Hall*, 318 N.C. 421, 349 S.E.2d 552, 556, 557 [4-6] (N.C. 1986).

DAI filed a petition to stay the North Carolina state court lawsuit pending arbitration under 9 U.S.C. § 3. This is the only case in which DAI actually litigated a state court claim under 9 U.S.C. § 3. DAI also filed a motion to dismiss the North Carolina

state court lawsuit on the ground that the arbitration clause provides that arbitration is a condition preceded to litigation. The franchisee responded by arguing that he was fraudulently induced into the arbitration agreement and that the arbitration agreement lacked mutuality. Affidavits were filed by both sides and oral argument was held after briefs had been filed.

The record established that the North Carolina trial court necessarily denied the motion to stay under 9 U.S.C. § 3 and the motion to dismiss on one or both of the two defenses to arbitration asserted by Michael Johnson, i.e. (1) fraud with respect to the arbitration agreement and/or (2) lack of mutuality in the arbitration agreement.

DAI appealed those orders to the North Carolina court of appeals and has filed its brief as appellant. The

injunction issued by the Connecticut District Court has precluded Michael Johnson from filing his responsive brief in the North Carolina court of appeals.

The Second Circuit concluded that the North Carolina appealable orders were not entitled to preclusive effect under North Carolina law because they did not state which of the two alternative grounds formed the basis for the North Carolina trial court orders. *See* the Appendix at pages 26a-28a.

Since both of the alternative issues would render the arbitration clause void and unenforceable, according to the North Carolina courts, the North Carolina courts clearly would give preclusive effect to the prior North Carolina trial court appealable orders in this case.

It is not the role of the Federal Courts to determine whether the North

Carolina court was or was not correct in concluding that lack of mutuality would render the arbitration clause void and unenforceable. The only issue before the Federal Courts is whether the North Carolina courts could give preclusive effect to those rulings.

Petitioners submit that it would elevate form over substance to the highest degree to conclude that the North Carolina courts would not give preclusive effect to those prior North Carolina trial court appealable orders on the grounds that the orders do not clearly delineate which of the two reasons, or both, form the basis for those decisions.

The Full Faith and Credit Statute, 28 U.S.C. § 1738 and *Allen v. McCurry*, 449 U.S. 90, 95 [6], 101 S.Ct. 411, 66 L.Ed.2d 308 (1980) require the Federal Courts to give full faith and credit to

the prior North Carolina appealable trial court orders.

(4) The Court should grant the Petition to resolve the conflict between the Second Circuit and this Court's prior opinion in *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) on whether the Federal Courts should abstain from exercising subject matter jurisdiction, in view of the eleven prior state court judgments holding the arbitration clauses void and unenforceable.

All of the factors which require the Federal Courts to abstain from exercising jurisdiction, in cases of this type, that were absent in the *Moses Cone* cases, are present here. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 16, 16, 74 L.Ed.2d 765, 779, 780, 103 S.Ct. 927 (1983). Connecticut is geographically

inconvenient for all of the defendants-franchisees. DAI is a Florida corporation with is principal office and place of business in Florida. The exercise of jurisdiction by the Connecticut Federal Court has resulted in extensive, piecemeal, litigation. The state court cases are far advanced in comparison to the Federal Court cases. Eleven state courts have already ruled that the arbitration clauses are void and unenforceable. Prior state court appellate opinions have held that DAI waives its right to arbitrate when it files eviction lawsuits in the name of its alter-ego leasing companies to resolve disputes under the franchise agreement. *Yates v. Doctor's Associates, Inc.*, 193 Ill.App.3d 431, 549 N.E.2d 1010 (Ill. App. 1990). Illinois appellate courts have previously approved the award of $1

million in punitive damages against DAI, in favor of a franchisee, on the grounds, among others, that this method of resolving disputes constitutes a fraud on the franchisee. *Cox v. Doctor's Associates, Inc.*, 245 Ill.App.3d 186, 613 N.E.2d 1306 (Ill. App. 1993), petition for leave to appeal denied, 152 Ill.2d 556 (1993), cert. denied 114 S.Ct. 1069 (1994). Appeals by DAI in the underlying state court cases are currently pending in the Alabama Supreme Court, the North Carolina Court of Appeals and the Illinois Court of Appeals.

The Second Circuit ordered the District Courts to resolve the arbitration defenses of fraud, alter-ego and waiver.

These issues have previously been tried and decided against DAI in the 11 prior state trial court decisions and in

the prior Illinois appellate court opinions cited above.

Surely the principles of abstention require the Federal Courts to abstain from retrying the same issues that have previously been tried, retried and appealed, unsuccessfully, by DAI on numerous prior occasions.

The purposes the Full Faith and Credit Statute, 28 U.S.C. § 1738, are to reduce unnecessary litigation, foster reliance upon adjudication and promote comity between the state and Federal Courts. *Allen v. McCurry*, 449 U.S. 90, 95 [6], 101 S.Ct. 411, 66 L.Ed.2d 308 (1980).

Under our dual federal/state system of jurisprudence, the lower Federal Courts are not superior to the state courts. *Lion Bonding & Surety Co. v. Caratz*, 262 U.S. 77, 90, 43 S.Ct. 480, 484, 67 L.Ed. 871 (1923), cited with

approval in *Doctor's Associates, Inc. v. Distajo*, 66 F.3d 438, 448 [6] (2nd Cir. 1995). *See* the Appendix at page 22a.

The failure to abstain from exercising subject matter jurisdiction, in the cases at bar, converts the lower Federal Court into a court of appeals for the state courts.

CONCLUSION

For one or more of the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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January 2, 1996

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UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1724, 1725, 1726, 1988—August Term, 1994

(Argued: June 7, 1995 Decided: September 12, 1995)

Docket Nos. 94-9207, 94-9293, 94-9209, 95-7183

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

—v.—

EMILY DISTAJO, RENATO DISTAJO, CONSTANTINO LAMANDO, MILO LAMANDO, JOSE ALBERTO BRENES, ALVARO GUERRERO, MARIA T. GUERRERO, WESAM S. YOUMARAN, LINDA YOUMARAN, JULIE SHINO, JOHNSON SHINO, ALBERT YONAN, LEYLAH YONAN, LOUIS LOENNEKE, MARY ANN BOOKOUT, MICHAEL JOHNSON, DEBORAH A. KANE, GREGORY F. KANE, BRUNO GIANINNI, RONALD ROTHMUND, PATRICIA ROTHMUND, JOHN S. PAPALEO, JOHN A. MCCRARY, JOHN GILLON, SONYA SMITH, PAUL RIISE, MELISSA RIISE, and RHONDA BENTON,

Defendants-Appellants.

—and—

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

—v.—

RAYMOND BICKEL and SANDRA BICKEL,

Defendants-Appellants.

Before:

MINER, LEVAL and CABRANES,

Circuit Judges.

Appeal from several orders of the United States District Court for the District of Connecticut (Peter C. Dorsey, *Chief Judge*), denying certain appellants' motions to dismiss, granting appellee's petitions to compel arbitration, and entering a preliminary injunction barring appellants from pursuing parallel state litigation. Appellants contend that (1) the district court lacked subject matter jurisdiction; (2) the district court should have accorded preclusive effect to judgments entered in state courts against DAI; (3) the arbitration clause is void for "lack of mutuality"; (4) DAI waived its right to compel arbitration by initiating litigation through a shell corporation; and (5) the district court should have decided whether the appellants were fraudulently induced to enter the arbitration agreement, rather than leaving that question for the arbitrators.

Reversed in part and affirmed in part.

DAVID M. DUREE, Reinert, Duree & Crane, St. Louis, Missouri, *for Defendants-Appellants Emily Distajo, Renato Distajo, Constantino Lamando, Milo Lamando, Jose Brenes, Alvaro Guerrero, Maria Guerrero, Wesam Youmaran, Linda Youmaran, Julie Shino, Johnson Shino, Albert Yonan, Leylah Yonan, Louis Loenneke, Mary Ann Bookout, Michael Johnson, Deborah A. Kane, Gregory F. Kane, Bruno Gianinni, Ronald Rothmund, Patricia Rothmund, John S. Papaleo, Raymond Bickel and Sandra Bickel.*

Edward E. Angwin, Birmingham, Alabama, *for Defendants-Appellants John A. McCrary, John Gillon, Sonya Smith, Paul Riise, Melissa Riise, and Rhonda Benton.*

Nicholas Wocl, Tooher, Puzzuoli & Wocl, Stamford, Connecticut, *for all Defendants-Appellants.*

EDWARD WOOD DUNHAM, Wiggin & Dana, New Haven, Connecticut, *for Plaintiff-Appellee.*

JOSÉ A. CABRANES, *Circuit Judge*:

This case is about forum-shopping, by one and all. Doctor's Associates, Inc. ("DAI") is the national franchisor of Subway sandwich shops. DAI and its franchisees entered into standard franchise agreements,

which required them to arbitrate all contractual disputes in Bridgeport, Connecticut, under Connecticut law. When problems did arise, however, neither side invoked the arbitration clause. First, DAI directed its wholly owned real-estate leasing companies to bring summary eviction proceedings against the franchisees in local state courts.[1] The franchisees, in turn, scrambled to obtain judgments against DAI in local state courts.

When DAI found itself faced with state court claims around the country, it sought shelter in the arbitration clause of its franchise agreements. Accordingly, it petitioned the federal district court in Connecticut to compel arbitration under the Federal Arbitration Act. Before the district court could act, some of the franchisees won state court judgments against DAI. But DAI eventually convinced the district court to enjoin the franchisees from pursuing their state actions—even from enforcing judgments already entered—and to send the parties to Bridgeport to resolve their disputes around the arbitral table.

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[1] DAI and other franchisees have been involved in similar litigation around the country. *See, e.g., Kroll v. Doctor's Assocs., Inc.*, 3 F.3d 1167 (7th Cir. 1993); *Mosca v. Doctors Assocs., Inc.*, 852 F. Supp. 152 (E.D.N.Y. 1993); *Wilson v. Subway Sandwiches Shops, Inc.*, 823 F. Supp. 194 (S.D.N.Y. 1993); *In re Sims*, 1991 U.S. Dist. LEXIS 13664 (E.D. La. 1991); *Yates v. Doctor's Assocs., Inc.*, 193 Ill. App. 3d 431, 549 N.E.2d 1010 (5th Dist. 1990); *Cox v. Doctor's Assocs., Inc.*, 245 Ill. App. 3d 186, 613 N.E.2d 1306 (5th Dist.), *appeal denied*, 152 Ill.2d 556 (1993), *cert. denied*, 114 S. Ct. 1069 (1994); *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (1994), *vacated and remanded*, 115 S. Ct. 2552 (1995).

The relationship between DAI and the Bickels' landlord has also been the subject of litigation. *Jannotta v. Subway Sandwich Shops, Inc.*, 1995 U.S. Dist. LEXIS 7586 (N.D. Ill. 1995).

On appeal, we are presented with several questions relating to the Federal Arbitration Act: (1) whether a district court has subject matter jurisdiction over a petition to compel arbitration where there is complete diversity among all the parties to the arbitration agreement (all of whom are joined as parties in the petition), but where other, nondiverse parties have been joined as defendants in a parallel state action involving the same underlying dispute; (2) whether the district court should have accorded preclusive effect to various state court judgments entered in Alabama, Illinois, and North Carolina courts; (3) whether an arbitration clause is void for "lack of mutuality" under Connecticut law if it requires only one party to submit disputes to arbitration; (4) whether a party to an arbitration agreement waives its right to compel arbitration when it litigates substantial issues through an alter ego; and (5) whether a district court or an arbitrator should decide whether a party was fraudulently induced to assent to an arbitration agreement.

The district court found complete diversity, refused to accord preclusive effect to the state court judgments, found that the arbitration clause did not lack mutuality, held that DAI had not waived its right to arbitrate regardless of whether its leasing affiliates, which brought the court proceedings, were its alter egos, and left the question of fraudulent inducement to the arbitrators. As discussed below, we affirm in part and reverse in part.

I. FACTS

Doctor's Associates, Inc. ("DAI"), a Florida corporation, is the national franchisor of "Subway" sandwich shops. DAI entered into identical franchise agreements

with each of the defendant franchisees (the "Franchisees").[2] Each agreement contains an identical arbitration clause, which provides that any claim arising out of or relating to the franchise agreement must be arbitrated in Bridgeport, Connecticut, under the Commercial Arbitration Rules of the American Arbitration Association. According to the arbitration clause, no party may take legal action against the other in connection with the franchise agreement without first attempting to arbitrate the dispute.[3]

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[2] For convenience, we shall refer to the franchisees individually according to the following case numbers, or collectively according to the state in which they brought suit, e.g., the "Alabama franchisees." We list the district court docket number, as well as the state of each group of franchisees whose cases were consolidated under the heading of *Doctor's Associates, Inc. v. Distajo*:

Case #1: 3:94-CV-349 *Doctor's Associates, Inc. v. Distajo* (IL)
Case #2: 3:94-CV-511 *Doctor's Associates, Inc. v. Brenes* (IL)
Case #3: 3:94-CV-514 *Doctor's Associates, Inc. v. Guerrero* (IL)
Case #4: 3:94-CV-515 *Doctor's Associates, Inc. v. Youmaran* (IL)
Case #5: 3:94-CV-516 *Doctor's Associates, Inc. v. Shino* (IL)
Case #6: 3:94-CV-517 *Doctor's Associates, Inc. v. Loenneke* (IL)
Case #7: 3:94-CV-803 *Doctor's Associates, Inc. v. Johnson* (NC)
Case #8: 3:94-CV-354 *Doctor's Associates, Inc. v. McCrary* (AL)
Case #9: 3:94-CV-369 *Doctor's Associates, Inc. v. Gillon* (AL)
Case #10: 3:94-CV-370 *Doctor's Associates, Inc. v. Smith* (AL)
Case #11: 3:94-CV-371 *Doctor's Associates, Inc. v. Risse* (AL)
Case #12: 3:94-CV-372 *Doctor's Associates, Inc. v. Benton* (AL)
Case #13: 3:94-CV-948 *Doctor's Associates, Inc. v. Kane* (MA)
Case #14: 3:94-CV-1108 *Doctor's Associates, Inc. v. Giannini* (PA)
Case #15: 3:94-CV-1456 *Doctor's Associates, Inc. v. Rothmund* (IL)
Case #16: 3:94-CV-1457 *Doctor's Associates, Inc. v. Papaleo* (IL)

Although *DAI v. Bickel* was not consolidated with the other sixteen cases before the district court, it was consolidated for purposes of oral argument before this court.

[3] The arbitration clause provides as follows:

Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and

DAI requires each franchisee to sublease its premises from one of several real-estate leasing companies that are wholly owned by DAI. Each sublease contains a "cross-default" provision, whereby any breach of the franchise agreement by the franchisee constitutes a breach of the sublease.[4] According to the deposition testimony of one of its own officers, DAI wanted its leasing affiliate to be the franchisees' sublessor to obtain greater leverage over them in the event of a dispute.

A. *The District Court Proceedings in Doctor's Associates, Inc. v. Distajo (Nos. 94-9207, 94-9209, 94-9293)*

From 1991 through 1993, various disputes arose between DAI and the several franchisees. DAI never filed any demands for arbitration, despite its claims that the franchisees had breached the franchise agreements. Instead, DAI directed its leasing companies to invoke the cross-default provisions of the subleases, and to institute eviction proceedings in state courts against each franchisee.

In response to these eviction proceedings, each of the franchisees filed a state court action claiming, *inter alia*,

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judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

[4] The cross-default provision reads in relevant part as follows:

If at any time during the term of this Sublease, Sublessee shall default in the performance of any of the terms, covenants or conditions of the aforesaid Franchise Agreement . . . Sublessor, at its option, may terminate this lease . . . and upon such termination, Sublessee shall quit and surrender the leased premises to Sublessor . . . .

fraud and breach of contract by DAI, its leasing companies, and several of DAI's officers and agents.

According to the franchisees, DAI uses this subleasing arrangement to circumvent the arbitration clause in the franchise agreements. They argue that the leasing companies are mere shells, or alter egos, of DAI. It is undisputed that the leasing companies are wholly owned by DAI, that they have no assets or net income, and that DAI decides when the leasing companies will file eviction proceedings. Pursuant to the sublease, the franchisee must pay rent directly to the actual landlord; no rent is paid to the leasing company. According to the franchisees, DAI has taken the position that the arbitration clause in the franchise agreement is not binding on its leasing companies, because they are not parties to that agreement. The franchisees claim also that the leasing companies have asserted the right to proceed with eviction lawsuits against the franchisees even if the franchisees file arbitration demands against DAI. Thus, DAI allegedly brought eviction lawsuits through its leasing companies to pressure its franchisees into resolving disputes, but invokes the arbitration clause to protect itself against litigation initiated by the franchisees.

DAI responded to each state lawsuit brought by the franchisees by serving a demand for arbitration pursuant to the franchise agreement. When the franchisees refused to arbitrate their disputes, DAI filed petitions to compel arbitration, pursuant to the Federal Arbitration Act, 9 U.S.C. § 4, in the United States District Court for the District of Connecticut. All sixteen cases were eventually consolidated before Chief Judge Peter C. Dorsey. Before the district court ruled on DAI's petitions, the state courts in Alabama, Illinois, and North Carolina

entered judgments in favor of the franchisees in Cases 1-12 and 15-16.

In the district court, DAI contended that the franchisees were bound by the franchise agreement to submit any disputes with DAI to arbitration in Bridgeport, Connecticut, before instituting judicial proceedings. The franchisees responded by seeking dismissal of DAI's petitions on several grounds, including, *inter alia*: (1) lack of subject matter jurisdiction, due to incomplete diversity of the parties; and (2) collateral estoppel, based on the intervening state court judgments. The district court rejected each of these contentions in a ruling dated September 29, 1994. The district court simultaneously rejected DAI's motion to enjoin the franchisees from pursuing parallel state court proceedings, on the grounds that the requested injunction did not fall within any of the narrow exceptions to the Anti-Injunction Act, 28 U.S.C. § 2283.

On November 10, 1994, the district court granted DAI's petitions to compel arbitration. In doing so, the court rejected several defenses raised by the franchisees, including the following: (1) that the arbitration clause was void for lack of mutuality; (2) that DAI had waived arbitration by virtue of its leasing companies' prosecution of eviction lawsuits; and (3) that DAI had fraudulently misrepresented the scope of the arbitration clause in the franchise agreement. The court held that the arbitrators, not the court, should determine whether the leasing companies were "alter egos" of DAI, and then address the question whether DAI had fraudulently misrepresented the scope of the arbitration agreement.

When the franchisees continued to pursue their state court actions, DAI obtained a temporary restraining

order from the district court on November 22, 1994, preventing them from participating in the parallel state proceedings. On December 14, 1994, the district court entered a preliminary injunction, barring the Distajo franchisees from seeking enforcement of their Illinois judgment. *Doctor's Assocs., Inc. v. Distajo*, 870 F. Supp. 34 (D. Conn. 1994). The court concluded that injunctive relief was "not inappropriate" under the Anti-Injunction Act, 28 U.S.C. § 2283, because continued state litigation would "impair the integrity of the order of arbitration." In granting DAI's motion, the court rejected the franchisees' argument that an intervening judgment entered in favor of the Distajo franchisees by an Illinois state court on October 24, 1994, was "final" for *res judicata* purposes and would preclude entry of the injunction under the full faith and credit statute, 28 U.S.C. § 1738.

All of the franchisees filed timely appeals from the district court's order of September 29, 1994, denying their motions to dismiss, and the order of November 10, 1994, compelling arbitration. All of the franchisees except those from Alabama (Cases 8-12) also appeal from the court's December 9, 1994, order entering the preliminary injunction.

B. *The District Court Proceedings in Doctor's Associates, Inc. v. Bickel (No. 95-7183)*

The proceedings in the *Bickel* case differ somewhat from those cases consolidated under the *Distajo* rubric. On December 16, 1994, the Bickels filed a complaint in Illinois state court against DAI, its leasing company, its development agent, and three DAI officers. DAI responded by filing a petition to compel arbitration in the United States District Court for the District of Connecticut on January 20, 1995, and moved to enjoin the

Bickels from prosecuting their state court action. On February 7, 1995, the Illinois court entered a default judgment against DAI. On February 13, 1995, Chief Judge Dorsey granted both DAI's petition to compel arbitration and its motion for a preliminary injunction, while permitting DAI to move the Illinois court to vacate the default judgment on the basis of defective service of process. The district court entered a written order embodying the *Bickel* injunction on May 9, 1995, but did not order DAI to post a bond.

The Bickels appeal from the court's order of May 9, 1995, granting DAI's petition to compel arbitration and entering the preliminary injunction.

I. DISCUSSION

"When reviewing a district court's determination of its subject matter jurisdiction, we review factual findings for clear error and legal conclusions de novo." *In re Vogel Van & Storage, Inc.*, 59 F.3d 9, 11 (2d Cir. 1995). We also review *de novo* the district court's decision to compel arbitration. *Collins & Aikman Prods. Co. v. Building Systems, Inc.*, 58 F.3d 16, 19 (2d Cir. 1995).

A. *Subject Matter Jurisdiction*

Section 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, confers jurisdiction on district courts to hear petitions to enforce arbitration agreements, but only to the extent that the court would otherwise have jurisdiction over the dispute. The statute provides as follows:

> A party aggrieved by the alleged . . . refusal of another to arbitrate under a written agreement for

> arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action . . . of the subject matter of *a suit arising out of the controversy between the parties*, for an order directing that such arbitration proceed in the manner provided for in such agreement.

9 U.S.C. § 4 (emphasis added). As the Supreme Court has explained,

> [t]he Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 (1976 ed., Supp. V) or otherwise. Section 4 provides for an order compelling arbitration only when the federal district court would have jurisdiction over a suit on the underlying dispute; hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983).

The parties seem to agree that the only possible basis for federal subject matter jurisdiction in this case would be diversity of citizenship. 28 U.S.C. § 1332. It is a long-settled rule that in order to invoke diversity jurisdiction, the petitioner must show "complete diversity"—that is, that it does not share citizenship with any defendant. *C. T. Carden v. Arkoma Assocs.*, 494 U.S. 185, 187 (1990); *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267, 267 (1806), *overruled on other grounds*, 43

U.S. (2 How.) 497, 555 (1844); *Curley v. Brignoli, Curley & Roberts Assocs.*, 915 F.2d 81, 84 (2d Cir. 1990), *cert. denied*, 499 U.S. 955 (1991). DAI is a Florida corporation with its principal place of business in Florida. The franchisees are residents of Alabama, Illinois, Massachusetts, North Carolina, and Pennsylvania.

The franchisees argue that there is not complete diversity of citizenship here. According to the franchisees, the "controvers[ies] between the parties" to which the FAA refers involve not only DAI, but also DAI's development agents—some of whom share the same citizenship with certain franchisees. None of those agents was a party to the franchise agreement; none has been joined as a party in the present proceeding. These local DAI agents, the franchisees contend, are "indispensable parties" to the present federal action, as evidenced by the fact that the affiliates are named defendants in the franchisees' state actions. In other words, the franchisees argue that their state court actions are the "suit[s] arising out of the controversy between the parties" hypothesized by the FAA. If so, then the citizenship of all the parties in the state actions determines whether there is complete diversity in the federal action to compel arbitration. Because these agents cannot be joined without destroying diversity, the franchisees argue that the district court should have dismissed the petitions to compel.

DAI responds that the "suit arising out of the controversy between the parties" is DAI's action to compel arbitration—not the parallel state action—and that DAI's affiliates are not "indispensable parties" to the federal action. Accordingly, DAI argues that we should look at the citizenship only of the parties named in the petition to compel, when determining whether there is diversity jurisdiction. *Prudential-Bache Sec., Inc. v. Fitch*, 966

F.2d 981, 988 (5th Cir. 1992) ("jurisdiction for a petition to compel arbitration [must] be determined from the face of the petition"). DAI offers a textual argument and a policy argument to support its position. First, it notes that the FAA asks whether the district court would have jurisdiction over a suit arising out of a controversy "between the parties." The phrase "the parties" most sensibly refers to those persons who are parties to the arbitration agreement—and who therefore can be named in the petition to compel arbitration. Second, DAI argues that the FAA would be fatally undermined if "the parties" described in § 4 could be expanded to include persons who had not signed the arbitration clause but who allegedly were involved in the "underlying controversy." If such a rule were adopted, a party resisting arbitration could defeat federal jurisdiction simply by suing someone from the same state, plus the party seeking to compel arbitration, in a separate state lawsuit. Diversity would be destroyed simply by claiming that the local defendants in the parallel action were "indispensable parties" to the petition to compel.

We agree with DAI. The "parties" to which § 4 of the FAA refers are the parties to the petition to compel. As with any federal action, diversity of citizenship is determined by reference to the parties named in the proceeding before the district court, as well as any indispensable parties who must be joined pursuant to Rule 19 of the Federal Rules of Civil Procedure. Where joinder of a party would destroy subject matter jurisdiction, the court must dismiss the action if that party is "indispensable" to the litigation. Fed. R. Civ. P. 19(b)[5]; *Fluent*

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[5] Rule 19(b) provides:

> Determination by Court Whenever Joinder not Feasible. If a person as described in subdivision (a)(1)-(2) hereof cannot be made a

v. Salamanca Indian Lease Auth., 928 F.2d 542, 548 (2d Cir.) (finding dismissal proper where indispensable party was Indian tribe that enjoyed sovereign immunity from suit), *cert. denied*, 502 U.S. 818 (1991). But individuals who are not parties to the arbitration agreement cannot be "indispensable" parties under Rule 19(b) if they do not meet either of the threshold tests of Rule 19(a).[6] That provision only requires joinder of a party if (1) the court cannot afford "complete relief" to those already joined, in the absence of that party, and (2) the unjoined party has an interest in the litigation and his absence may either impede his ability to protect that interest or subject the already-joined parties to a risk of inconsistent obligations—which often means the risk of piecemeal litigation. Neither condition is satisfied in the present case. First, the district court can grant all the

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party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable. The factors to be considered by the court include: first, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

6 Rule 19(a) provides that

A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest.

relief sought by DAI in this case—an order compelling arbitration—regardless of whether DAI's development agents (nonparties to the arbitration agreement) are present. Second, the other consideration set forth in Rule 19(a)—possible prejudice resulting from piecemeal litigation—is overcome in this context by the FAA's strong bias in favor of arbitration. Indeed, the Supreme Court has categorically stated that the FAA requires courts to enforce an arbitration agreement "notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." *Moses H. Cone*, 460 U.S. at 20. A district court should not consider the citizenship of strangers to the arbitration contract, since they are not "parties" the suit arising out of the controversy within the meaning of the FAA.

Accordingly, we hold that the district court was correct in looking only to the citizenship of the parties in the action before it—that is, DAI and the franchisees, who signed the arbitration agreement—to determine whether there was complete diversity. (JA 643) Because the parties conceded at oral argument that DAI and the franchisees are completely diverse, we affirm the district court's finding that it possessed subject matter jurisdiction pursuant to 28 U.S.C. § 1332 and 9 U.S.C. § 4.

B. *Preclusive Effect of State Court Judgments*

The franchisees claim that the district court should have accorded full faith and credit to the various state court judgments that found the arbitration clause unenforceable in cases involving DAI and various of the defendant franchisees.

The full faith and credit statute, 28 U.S.C. § 1738, provides that "[state] judicial proceedings . . . shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." Accordingly, a federal court must "give preclusive effect to state-court judgments whenever the courts of the State from which the judgments emerged would do so." *Allen v. McCurry*, 449 U.S. 90, 96 (1980); *Valley Disposal, Inc. v. Central Vermont Solid Waste Management Dist.*, 31 F.3d 89, 98 (2d Cir. 1994).

The parties agree that the question, therefore, is whether the various state court judgments (one in Alabama, eight in Illinois, and one in North Carolina) would be accorded preclusive effect under Alabama, Illinois, or North Carolina law, respectively. We address each state's law in turn.

1. ***The Alabama Judgment (Case # 8)***

During October 1993, DAI's real-estate leasing company and its equipment leasing company filed suit against franchisee John McCrary in the Circuit Court of Talladega County, Alabama. In December 1993, McCrary filed a counterclaim against those DAI affiliates, and added DAI and its Alabama development agents as cross-claim defendants. On January 25, 1994, DAI and its affiliates filed a motion to dismiss the counterclaims and cross-claims or, in the alternative, to stay the Alabama case pending arbitration. DAI claims that it withdrew that motion after filing its petition to compel arbitration in the district court in Connecticut on March 8, 1994. On June 28, 1994, McCrary filed in the Alabama court a "Motion to Determine Non-Arbitrability of Issues."

On July 7, 1994, the Alabama Circuit Court ruled that the arbitration clause was void and unenforceable "for any of the following independent reasons": (1) lack of mutuality; (2) fraudulent inducement; (3) waiver by DAI of the right to invoke the arbitration clause; and (4) invalidity of the clause under Alabama law prohibiting all arbitration agreements, since the agreement lacked a sufficient "interstate nexus" to permit application of the FAA (which preempts state laws invalidating arbitration clauses affecting interstate commerce). The court also held that the issues raised in McCrary's counterclaim fell outside the scope of the arbitration clause. The Alabama court then expressly found "no just reason for delay" and accordingly directed that final judgment be entered in favor of McCrary.

DAI subsequently filed a motion for reconsideration, which the Alabama court denied on September 28, 1994. McCrary represents to this court that DAI subsequently appealed these orders to the Alabama Supreme Court. (The parties have been barred from proceeding with that appeal pursuant to the preliminary injunction entered by the district court on December 9, 1994.)

In an order entered September 29, 1994, denying McCrary's motion to dismiss, the district court declined to give preclusive effect to this Alabama judgment. The court reasoned that because a motion to reconsider the judgment was still pending in state court, there was not yet a final judgment on the merits. Thus, principles of *res judicata* and collateral estoppel would not apply.

On appeal, DAI concedes that the Alabama ruling was indeed "final" for the purposes of preclusion. Under Alabama law, an order entered upon less than all of the claims presented in an action is a final, appealable order

if "the judge makes an express determination that there is no just reason for delay . . . ." *Goza v. Everett*, 365 So. 2d 658, 659 (Ala. 1978). "Alabama courts, like federal courts, generally apply the same test of finality for purposes of preclusion as they do for appealability." *Stone v. Williams*, 970 F.2d 1043, 1055 (2d Cir. 1992), *cert. denied*, 113 S. Ct. 2331 (1993); *see also First Ala. Bank of Montgomery, N.A. v. Parsons Steel, Inc.*, 825 F.2d 1475, 1480 (11th Cir. 1987) (interpreting Alabama law), *cert. denied sub nom. McGregor v. First Ala. Bank of Montgomery*, 484 U.S. 1060 (1988). Because the Circuit Court of Talladega County expressly found that its decision was final and that there was no reason for delay, its July 7, 1994, order was immediately appealable and thus would be accorded preclusive effect under Alabama law as of that date.

DAI urges this court nevertheless to disregard the Alabama judgment, for three reasons. First, DAI argues that the Supreme Court's decision in *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834 (1995), overturned the interstate commerce analysis that provided the Alabama court's fourth rationale for voiding the arbitration clause. The Supreme Court's decision, DAI contends, constitutes an "intervening change in the applicable legal context," *Staten Island Rapid Transit Operating Auth. v. ICC*, 718 F.2d 533, 543 (2d Cir. 1983), that requires a federal court not to accord preclusive effect to the Alabama decision. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 28(2) (1980). Even if *Allied-Bruce* did undermine one rationale supporting the Alabama court's judgment, however, the Supreme Court's decision did not affect the alternate grounds set forth by the court for voiding the arbitration clause.

Because the legal context has not shifted at all in these other areas, we cannot reexamine the Alabama judgment.

Second, DAI contends that it was not afforded a "full and fair opportunity to litigate" the arbitration claims in the Alabama court. *See Milltex Indus. Corp. v. Jacquard Lace Co.*, 922 F.2d 164, 168 (2d Cir. 1991); *Stone*, 970 F.2d at 1056. DAI assigns error to three aspects of the procedure followed in the Alabama court, each of which we reject. (1) DAI complains that it was not afforded the right to file a brief in response to McCrary's "Motion to Determine the Non-Arbitrability of the Issues." But as DAI conceded at oral argument before this court, nothing in the record indicates that it ever sought to file such a brief, much less that the Alabama court prevented it from filing one. Absent any evidence to the contrary, we accept the statement in the written order of the Alabama court that "[b]oth sides have thoroughly briefed the issues and provided factual evidence in support of their respective positions." (2) DAI also claims that it was not afforded "meaningful oral argument." Because DAI does not claim that oral argument was completely denied, we dismiss the argument out of hand. This court has held that "[o]ral argument is not a necessary component of due process in all circumstances." *Zaluski v. INS*, 37 F.3d 72, 73 (2d Cir. 1994); *see also FCC v. WJR, The Goodwill Station, Inc.*, 337 U.S. 265, 276 (1949) ("Certainly the Constitution does not require oral argument in all cases where only insubstantial or frivolous questions of law, or indeed even substantial ones, are raised."). Courts have broad discretion to determine how much, if any, oral argument is appropriate in a given case. We will not second-guess the Alabama court's allocation of its time. (3) Finally, DAI argues that the Alabama court drastically misapplied the law. This argument is nothing

more than an invitation for this court to revisit the merits of the Alabama court's judgment—precisely what the full faith and credit statute tells us not to do. *See Charles Koen & Assocs. v. City of Cairo*, 909 F.2d 992, 1000 n.8 (7th Cir. 1990) ("The full faith and credit statute does not permit federal courts to reassess the merits of state court judgments."). "Lower federal courts are not superior to state courts." *Lion Bonding & Sur. Co. v. Karatz*, 262 U.S. 77, 90 (1923); *see also District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 482 (1983) ("[A] United States District Court has no authority to review final judgments of a state court in judicial proceedings."). If DAI is dissatisfied with the judgment of the Alabama trial court, it should take an appeal.

Third, DAI argues that there was no motion properly before the Alabama court that would permit it to decide the arbitrability issue. That is, DAI claims that it had already withdrawn its own motion to compel arbitration under § 3 of the FAA, and that McCrary's own "Motion to Determine the Non-Arbitrability of the Issues" was unauthorized, considering that McCrary had never sought a declaratory judgment in his complaint. According to DAI, the Alabama opinion is therefore purely "advisory," and is not entitled to preclusive effect under state law. This argument fails for two reasons. First, the Alabama court clearly believed that DAI's motion to dismiss had been submitted for decision, since it denied that motion on the merits. Second, *Stamps v. Jefferson County Board of Education*, 642 So. 2d 941, 944 (Ala. 1994), which DAI cites, does not support the proposition that a declaratory judgment is merely "advisory" if such relief was not specifically requested in the complaint. All the Alabama Supreme Court stated in *Stamps* was that "[a]ctions or opinions are denominated 'advisory,'

. . . where the judgment sought would not constitute specific relief to a litigant . . . ." 642 So. 2d at 944 (quoting EDWIN M. BORCHARD, DECLARATORY JUDGMENTS 34 (1934)) (emphasis deleted). In that case, a group of teachers had sued their employer and sought a judicial declaration that their work duties subjected them to prosecution by a state agency. The court held that such a declaratory judgment would be purely advisory because the prosecutorial agency had not been joined as a party, and thus would not be bound by the decision. *Id.* But DAI is a party in the Alabama action, and is bound by the state court judgment. Because the declaratory judgment finding the arbitration clause to be unenforceable provides "specific relief" to McCrary against DAI, as required by *Stamps*, it cannot be brushed aside as an "advisory" opinion.

For these reasons, we hold that the district court should have accorded full faith and credit to the Alabama judgment. Accordingly, we reverse the district court orders denying McCrary's motion to dismiss and compelling him to pursue arbitration. On remand, we direct the district court to dismiss DAI's petition to compel McCrary to arbitrate. Although McCrary did not appeal from the December 9, 1994 order entering the preliminary injunction, we nevertheless exercise our pendent appellate jurisdiction in the interests of judicial economy to vacate the injunction. *See Golino v. City of New Haven*, 950 F.2d 864, 868 (2d Cir. 1991) ("[W]here we have jurisdiction to consider some questions on appeal, we may exercise our discretion to take pendent jurisdiction over related questions."), *cert. denied sub nom. Lillis v. Golino*, 112 S. Ct. 3032 (1992).

2. *The Illinois Judgments (Cases ## 1-6, 15-16, DAI v. Bickel)*

Eight groups of Illinois franchisees[7] filed complaints against DAI, its leasing companies, and DAI's two co-owners, and their cases were eventually consolidated before the Circuit Court of Madison County, Illinois. On October 24, 1994, the Illinois court granted the franchisees' motion for summary judgment, declaring the arbitration clause void and unenforceable on several grounds. The court stated that its decision was a "final and appealable order and judgment under Illinois Supreme Court Rule 304(a) in that there is no just reason for delaying either the enforcement of or the appeal from this judgment and order."

DAI represented to the district court that it had filed a motion for reconsideration in the Illinois court, and that the possibility of appeal remained open. Reasoning that a judgment subject to appeal was not final under Illinois law, the district court refused to accord preclusive effect to the Illinois court's decision. The district court relied on *Pelon v. Wall*, 262 Ill. App. 3d 131, 135 (2d Dist. 1994), which held that "[f]or res judicata purposes, a judgment is not final until the possibility of appellate review has been exhausted."

The Bickels also filed a complaint against DAI and others in the Circuit Court of Madison County, on December 16, 1994. DAI failed to enter an appearance in Madison County within the prescribed time, so the Illinois court entered a default judgment in favor of the Bickels on February 7, 1994. In its judgment, the Illinois court declared the arbitration clause void and

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[7] Cases 1, 2, 3, 4, 5, 6, 15, 16, and *DAI v. Bickel*. *See supra* note 2 for the list of franchisees involved in each case listed here.

unenforceable, and scheduled a hearing on damages for April 4, 1995. On February 13, 1995, however, the district court ruled that for the purposes of issue preclusion, the Illinois judgment obtained by the Bickels was no more final than the judgment obtained by the other franchisees in Madison County. Accordingly, the district court granted DAI's petition to compel arbitration and enjoined the Bickels from continuing their Illinois litigation. The injunction contained an exception, however, which permitted DAI to move the Illinois court to set aside its default judgment.

The Illinois Supreme Court has held that an Illinois judgment is not final, and thus not entitled to preclusive effect, until the time for appeal has expired. *Bellweg v. City of Springfield*, 114 Ill. 2d 107, 113 (1986) ("For purposes of applying the doctrine of collateral estoppel, finality requires that the potential for appellate review must have been exhausted."); *Relph v. Board of Educ.*, 84 Ill. 2d 436, 442 (1981) (holding that an appellate court's mandate to remand with instructions for further proceedings establishes the law of the case, but does not constitute a final judgment entitled to res judicata effect—partially because the trial court's further proceedings are subject to subsequent appeal, and partially because the appellate court's mandate is subject to review by the Illinois Supreme Court); *see also People v. Condon*, 246 Ill. App. 3d 74, 76 (2d Dist. 1993) (holding that judgment is not final for purposes of preclusion until the potential for appellate review has been exhausted).

The franchisees respond by citing *Illinois Founders Insurance Co. v. Guidish*, 248 Ill. App. 3d 116, 120 (1st Dist. 1993), where it was said that

> [t]he pendency of an appeal has no effect on the finality of the order appealed from. Under certain circumstances, the pendency of an appeal can affect the enforceability of a judgment . . . but not its finality. More to the point, a final judgment can serve as the basis to apply the doctrines of res judicata and collateral estoppel even though the judgment is being appealed.

The Illinois Appellate Court's statement in *Guidish* is clearly at odds with the Illinois Supreme Court's categorical statements in *Bellweg* and *Relph*. *See Prymer v. Ogden*, 29 F.3d 1208, 1213 n.2 (7th Cir.) (discussing, but declining to resolve, conflict in authority), *cert. denied*, 115 S. Ct. 665 (1994). Despite the best efforts of the franchisees to distinguish *Bellweg* and *Relph*, we must follow the rulings of the Illinois Supreme Court.[8]

We hold that the district court correctly refused to accord preclusive effect to the Illinois judgments.

3. *North Carolina (Case #7)*

In April 1993, Michael Johnson filed a complaint against DAI and several affiliated individuals in the General Court of Justice, Superior Court Division, in Gaston County, North Carolina. Johnson alleged, *inter alia*, fraud, breach of contract, and conversion. DAI replied by filing two motions. First, it moved to stay the lawsuit pending arbitration. Second, it moved to dismiss Johnson's complaint, on the grounds that he had waived

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[8] We note that many of the franchisees' arguments were espoused in a *dissenting opinion* by a judge on the Illinois Appellate Court, who directly criticized the holding of *Bellweg* for deviating from the Restatement (Second) of Judgments § 13. *Southeastern Ill. Elec. Coop., Inc. v. Illinois Human Rights Comm'n*, 162 Ill. App. 3d 806, 814 (5th Dist. 1987) (Karns, J., dissenting), *appeal denied*, 119 Ill. 2d 575 (1988).

his right to challenge the arbitration agreement by previously participating in arbitration proceedings with DAI. Johnson, in turn, claimed that the arbitration clause was unenforceable on several grounds, including (1) that it lacked mutuality and (2) that he had been fraudulently induced into executing the arbitration agreement.

On May 3, 1994, the North Carolina court denied both of DAI's motions. In its written order, the court explicitly addressed only the issues raised in DAI's motion to dismiss: it held that Johnson's "limited participation in the arbitration proceedings did not constitute a waiver of his right to challenge the enforceability of the arbitration clause." With respect to DAI's *first motion*, however, the court did not explain why it denied the stay, nor did it make any findings of fact or conclusions of law regarding the arbitration clause.

Johnson argues that the North Carolina court *must* have relied on one of the rationales offered by Johnson (lack of mutuality or fraudulent inducement) even though the court did not specify which one. In North Carolina, however, collateral estoppel only precludes the relitigation of issues that were actually and necessarily decided in the earlier action. *King v. Grindstaff*, 200 S.E.2d 799, 805 (N.C. 1973). The party invoking the benefit of collateral estoppel (here, Johnson) bears the burden of establishing what was in fact determined by the prior judgment. *Thomas M. McInnis & Assocs., Inc. v. Hall*, 349 S.E.2d 552, 557 (N.C. 1986). Even if one of the issues raised by Johnson—mutuality or fraudulent inducement—was *necessarily* decided by the state judge, it is impossible to ascertain which issue was *actually* decided. We therefore hold that the judgment of the Gaston County court would not be accorded preclusive

effect under North Carolina law with respect to the validity of the arbitration clause.

Accordingly, we affirm the district court's decision not to accord full faith and credit to the judgment against DAI obtained by Johnson in the North Carolina court.[9]

C. *The Franchisees' Challenges to the Arbitration Clause*

1. *Mutuality*

The franchisees argue that the arbitration clause is void for lack of mutuality, in that it requires a franchisee to submit all controversies to arbitration but reserves to DAI (through its leasing companies) the right to seek summary eviction against the franchisees. The district court rejected this argument, finding no lack of mutuality: If the leasing companies were separable entities, then "the arbitration clause will be enforceable only as to DAI and the [franchisees], obliging them to arbitrate, thus establishing mutuality." If, on the other hand, the leasing companies were indistinguishable from DAI, then they too would be bound to arbitrate. Either way, the court reasoned, mutuality was not an issue.

We agree that mutuality is not an issue, but for different reasons. Preliminarily, we note that the parties have not offered any reason why we should not apply the choice-of-law clause in the franchise agreements, which

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[9] The district court refused to give full faith and credit to the North Carolina judgment on the grounds that it was subject to appeal, and thus did not constitute a final order entitled to preclusive effect. On appeal before this court, DAI concedes and we agree that the North Carolina judgment is a "final" order for the purposes of North Carolina preclusion law. *Sims v. Ritter Constr., Inc.*, 62 N.C. App. 52, 55, 302 S.E.2d 293, 295 (1983) (holding that interlocutory order affecting a substantial right is final and appealable, and entitled to *res judicata* effect under North Carolina law).

indicates that Connecticut law applies. Connecticut courts, however, have not addressed the precise question whether an arbitration clause may be void for "lack of mutuality."

The term "mutuality" can refer to several different concepts in contract law. Although it is unclear whether the franchisees are referring to "mutuality of obligation" or "mutuality of remedy," both doctrines are largely dead letters. The doctrine of "mutuality of obligation" requires a valid contract to be based on an exchange of reciprocal promises. 1A ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 152, at 3 (1963). As applied to arbitration clauses, that rule has been restated to mean that "the consideration exchanged for one party's promise to arbitrate must be the other party's promise to arbitrate." *Hull v. Norcom, Inc.*, 750 F.2d 1547, 1550 (11th Cir. 1985) (interpreting New York law). But "mutuality of obligation" has been largely rejected as a general principle in contract law, as well as in the arbitration context. The latest Restatement of Contracts provides that "[i]f the requirement of consideration is met, there is no additional requirement of . . . 'mutuality of obligation.' " RESTATEMENT (SECOND) OF CONTRACTS § 79 (1979). Option contracts, for example, are unquestionably valid under this modern rule despite their lack of "mutuality of obligation." That is, one party's promise to honor a future offer to purchase an item is valid if supported by the other party's present payment of a sum of money. The promise to *accept* the offer need not be supported by a reciprocal promise to *make* that offer. The New York Court of Appeals essentially adopted the Second Restatement position in a case involving a challenge to an arbitration clause which bound only one of the parties to arbitrate. In *Sablosky v. Edward S. Gordon Co.*,

73 N.Y.2d 133, 137, 538 N.Y.S.2d 513, 516 (1989), the court held that

> [i]f there is consideration for the entire agreement that is sufficient; the consideration supports the arbitration option, as it does every other obligation in the agreement. . . . Since it is settled that the validity of an arbitration agreement is to be determined by the law applicable to contracts generally . . . there is no reason for a different mutuality rule in arbitration cases.

Most courts facing this issue have arrived at the same conclusion. *See, e.g., Wilson Elec. Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167, 168 (6th Cir. 1989); *Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH*, 585 F.2d 39, 47 (3d Cir. 1978); *W.L. Jorden & Co. v. Blythe Indus.*, 702 F. Supp. 282, 284 (N.D. Ga. 1988); *Willis Flooring, Inc. v. Howard S. Lease Constr. Co. & Assocs.*, 656 P.2d 1184, 1185 (Alaska 1983) ("As one clause in a larger contract, the [arbitration] clause is binding to the same extent that the contract as a whole is binding."); *LaBonte Precision, Inc. v. LPI Indus. Corp.*, 507 So. 2d 1202, 1203 (Fla. Dist. Ct. App. 1987); *Kalman Floor Co. v. Jos. L. Muscarelle, Inc.*, 196 N.J. Super. 16, 481 A.2d 553 (1984), *aff'd for reasons stated below*, 98 N.J. 266, 486 A.2d 334 (1985). *Contra Stevens/Leinweber/Sullens, Inc. v. Holm Dev. & Management, Inc.*, 795 P.2d 1308, 1313 (Ariz. Ct. App. 1990); *R.W. Roberts Constr. Co. v. St. Johns River Water Management Dist.*, 423 So. 2d 630, 633 (Fla. Dist. Ct. App. 1982).

It has been argued that, according to the Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 403-04 (1967), an arbitration clause is separable from its underlying con-

tract, and therefore must be supported by separate consideration. *Stevens*, 795 P.2d at 1312-13. In *Prima Paint*, the Court held that a claim of fraud in the inducement of an underlying contract must be left to the arbitrators, but that a claim of fraud in the inducement of the arbitration clause should be decided by the court. *Prima Paint*, 388 U.S. at 403-04. In reaching this conclusion, the Court endorsed the result reached by our court in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959) (Medina, J.), *cert. granted*, 362 U.S. 909, *cert. dismissed for mootness*, 364 U.S. 801 (1960).[10] In *Robert Lawrence*, we described the FAA as distinguishing between "the entire contract between the parties on the one hand and the arbitration clause of the contract on the other," 271 F.2d at 409—the latter being described as a "separable part of the contract." *Id.* at 410. At one point in *Robert Lawrence*, we speculated that

> we would suppose that generally where the arbitration provision of the contract is sufficiently broad to encompass the issue of fraud, the mutual promises to arbitrate would form the *quid pro quo* of one another and constitute a separable and enforceable part of the agreement. We do not decide this point, however, as it is not necessarily before us.

Id. at 411. This passage, one might argue, indicates that an arbitration clause must be treated as a contract supported by independent consideration. For the following reasons, however, we reject this characterization.

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[10] *Prima Paint*, 388 U.S. at 400 ("We agree [with the result reached in *Robert Lawrence*], albeit for somewhat different reasons . . . .")

First, of course, we clearly labelled our statement in *Robert Lawrence* as dicta. Second, though we suggested that mutual promises to arbitrate could constitute sufficient consideration to support an arbitration agreement, we did not exclude the possibility that other consideration could support the agreement. Third, we indicated only that arbitration clauses are "separable" from void or voidable provisions of a contract—not that they are independent contracts. Although we consider an arbitration clause separately for the limited purpose of evaluating a claim of fraudulent inducement, we do not do so for all purposes. For example, when determining the parties' intent in the arbitration clause, we must read the contract as a whole. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1217 (1995) (quoting RESTATEMENT (SECOND) OF CONTRACTS. § 202(2) (1979)). State law generally governs the determination of whether the parties agreed to arbitrate a certain matter, *First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1924 (1995), and Connecticut courts "construe the contract as a whole" and consider "all relevant provisions . . . when determining the intent of the parties." *White v. Kampner*, 641 A.2d 1381, 1385 (Conn. 1994).

Wilson Electrical Contractors, Inc. v. Minnotte Contracting Corp., 878 F.2d 167, 169 (6th Cir. 1989), rejected the contention that under *Prima Paint*, "an arbitration clause is an independent contract that is separable from the main contract in which it is found and therefore must have all of the essential elements of a contract, including consideration." As the *Wilson* court pointed out, more recent decisions of the Supreme Court have consistently emphasized that the FAA is grounded in a strong federal policy favoring arbitration. *Id.* at 169. A doctrine that required separate consideration for arbi-

tration clauses might risk running afoul of that policy. In any event, because the franchisees make no claim that the underlying contract was the result of fraud, we have no occasion to consider the arbitration clause in isolation from the larger contract. Accordingly, we need not decide whether the arbitration clause must be supported by independent consideration.

The doctrine of "mutuality of remedy" affords no greater relief for the franchisees. That rule, which provides generally that a "plaintiff shall not get specific enforcement unless the defendant could also have obtained it," 5A ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1181, at 336 (1964), is also defunct. *See, e.g., Sablosky*, 73 N.Y.2d at 137 ("Mutuality of remedy is not required in arbitration contracts."). As explained in the latest Restatement,

> the law does not require that the parties have similar remedies in case of breach, and the fact that specific performance or an injunction is not available to one party is not a sufficient reason for refusing it to the other party. The rationale of the supposed requirement of "mutuality of remedy" is to make sure that the party in breach will not be compelled to perform without being assured that he will receive any remaining part of the agreed exchange from the injured party. It is therefore enough if adequate security can be furnished.

RESTATEMENT (SECOND) OF CONTRACTS § 363 cmt. c (1979).

In view of Connecticut's strong policies favoring arbitration, *see, e.g., White v. Kampner*, 229 Conn. 465, 471, 641 A.2d 1381, 1384 (1994); *Garrity v. McCaskey*, 223 Conn. 1, 7, 612 A.2d 742, 746 (1992), we believe that

the Connecticut courts would conclude that "where the agreement to arbitrate is integrated into a larger unitary contract, the consideration for the contract as a whole covers the arbitration clause as well." *W.L. Jorden & Co.*, 702 F. Supp. at 284. The franchisees do not contest that the franchise agreement as a whole is supported by consideration. Absent a failure of consideration, in this instance, we cannot invalidate the agreement in whole or in part.

2. *Waiver of Right to Pursue Arbitration*

The district court held that regardless of whether the leasing companies were DAI's alter egos, DAI had not waived its right to compel arbitration under the franchise agreement. On the one hand, if the leasing companies were not DAI's alter egos, then their pursuit of eviction proceedings against the franchisees could not be imputed to DAI. On the other hand, even if the leasing companies were DAI's alter egos, DAI nevertheless invoked its arbitration rights as soon as it was named a party in the various state court actions commenced by the franchisees. Somewhat opaquely, the court held that DAI "cannot be held to have waived a right of arbitration by an after-the-fact holding that it is the alter ego of the leasing companies." We disagree.

There is no authority to support the notion that a party is liable for acts of its alter ego only if a court has previously found that an alter-ego relationship exists. As we have explained in the context of contractual liability, "it is clear that the consequence of applying the alter ego doctrine is that the corporation and those who have controlled it without regard to its separate entity are treated as but one entity, and . . . the acts of one are the acts of all." *Fisser v. International Bank*, 282 F.2d 231, 234 (2d

Cir. 1960) (holding parent corporation bound to arbitrate, where its alter-ego instrumentality signed arbitration agreement); *see also Interocean Shipping Co. v. National Shipping & Trading Corp.*, 523 F.2d 527, 539 (2d Cir. 1975) (holding that company may be compelled to arbitrate even if not party to agreement containing arbitration clause, where company is alter ego of another party that clearly is subject to arbitration), *cert. denied*, 423 U.S. 1054 (1976). We believe that this principle applies with equal force in the present context. If DAI and its leasing companies should be treated as one and the same, then the initiation of eviction proceedings by the leasing companies must be imputed to DAI.

There remain two further questions: (1) whether the district court or the arbitrators should determine the waiver issue, and (2) what standard should be used by the appropriate decisionmaker. As to the first question, we note that the defense of waiver is generally referable to the arbitrators in cases involving petitions to compel under § 4 of the FAA—with one important exception which we shall shortly explain. In *World Brilliance Corp. v. Bethlehem Steel Co.*, 342 F.2d 362 (2d Cir. 1965), we squarely held that issues of waiver, like issues of fraud in the inducement of the entire contract, were properly resolved by the arbitrators, not the district court. *Id.* at 364-65. In reaching this conclusion, we pointed out that § 2 of the FAA makes an arbitration agreement enforceable " 'save upon such grounds as exist at law or in equity for the revocation of any contract.' " *Id.* at 364 (quoting 9 U.S.C. § 2). Waiver, we explained, does not constitute a ground for "revocation" of a contract within the meaning of § 2, and thus is not a basis for invalidating an arbitration contract. *Id.* Likewise, we explained that under § 4, a court is required to

grant a petition to compel arbitration except where a question of fact exists as to (1) "the making of the arbitration agreement" or (2) the "failure, neglect, or refusal of *another* [i.e., the respondent to the § 4 petition] to arbitrate." *Id.* at 364-65 (quoting 9 U.S.C. § 4 (emphasis added)). Because acts *by the petitioner* constituting waiver of the right to arbitrate did not fall within either of these enumerated categories, a district court cannot refuse to order arbitration under § 4 on a theory of waiver. *Id.* at 365. We reaffirmed this restrictive interpretation of § 4 in *Trafalgar Shipping Co. v. International Milling Co.*, 401 F.2d 568, 571 (2d Cir. 1968), where we held that most questions regarding the defense of laches should be decided "by the arbitrators, not the courts." In that case, we repeated that "[t]he only issues which the court is authorized to consider on a motion to compel arbitration are ones which pertain to 'the making of the arbitration agreement or the failure, neglect, or refusal to perform the same,' " *id.* at 571, and that the latter phrase referred to the failure of the *respondent* in a § 4 action to submit to arbitration, *id.* at 572.

Our decision in *World Brilliance* did not call into question, however, a parallel line of cases that considers waiver to be an equitable defense to a stay application under § 3 of the FAA, which a court is empowered to consider. Section 3 authorizes a court to stay proceedings pending arbitration, "providing the applicant for the stay is not in default in proceeding with such arbitration." 9 U.S.C. § 3. For example, in *Kulukundis Shipping Co. v. Amtorg Trading Corp.*, 126 F.2d 978 (2d Cir. 1942), a defendant sought to amend his answer nine months into the litigation and two months before trial, raising for the first time the defense that the case was arbitrable. *Id.* at 986. We construed the defendant's

motion to amend as an application for a § 3 stay of proceedings. *Id.* at 986 n.29. We explained that the proviso in § 3—that a stay shall be granted "providing the applicant for the stay is not in default in proceeding with such arbitration"—referred to a party "who, when requested, has refused to go to arbitration or who has refused to proceed with the hearing before the arbitrators once it has commenced." *Id.* at 989. We also noted with approval that, in other courts,

> [a] plaintiff who brought suit on a contract, without seeking to avail himself of its arbitration clause, has been held to have waived his rights thereunder, so that he could not subsequently, after a long delay, ask the court, under Section 3, to stay the action pending arbitration.

Id. We also indicated our agreement with a Fourth Circuit decision finding waiver of the right to arbitrate by a counterclaim defendant who participated at length in litigation, but on the eve of trial moved for a stay under § 3 of the FAA. *Id.* (describing *Radiator Specialty Co. v. Cannon Mills, Inc.*, 97 F.2d 318 (4th Cir. 1938)). The defendant in *Kulukundis* did not waive its right to arbitrate, we held, because it had not pursued litigation as extensively as had the parties in these other cases. 126 F.2d at 989.

We again equated a waiver of the right to arbitrate with a "default in proceeding with such arbitration" under § 3 in *Robert Lawrence*, 271 F.2d at 412; *see Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2d Cir. 1968) (deciding waiver issue where defendant moved for stay). The Court of Appeals for the District of Columbia Circuit apparently took the same view, when it explained that

> [t]he right to arbitration, like any other contract right, can be waived. A party waives his right to arbitrate when he actively participates in a lawsuit or takes other action inconsistent with that right. Once having waived the right to arbitrate, that party is necessarily "in default in proceeding with such arbitration."

Cornell & Co. v. Barber & Ross Co., 360 F.2d 512, 513 (D.C. Cir. 1966) (per curiam).

Yet some of our cases have also recognized that a court may consider a waiver defense to § 4 actions to compel arbitration as well as to § 3 stay applications—seemingly in derogation of our holding in *World Brilliance*. For example, in *Chatham Shipping Co. v. Fertex Steamship Corp.*, 352 F.2d 291, 293-94 (2d Cir. 1965), the petitioner had filed a complaint alleging breach of a contract but then filed a § 4 petition and moved to dismiss the first complaint, before the defendant had even filed an answer. We rejected the respondent's defense of waiver on the merits, even though *World Brilliance* had been decided only seven months earlier. In *Demsey & Associates, Inc. v. S.S. Sea Star*, 461 F.2d 1009, 1017 (2d Cir. 1972), where a defendant in a contract action pleaded arbitration "as an affirmative defense" after trial had been completed, we did not construe it as seeking either a § 3 stay or a § 4 order compelling arbitration. We held that the defendant's failure to raise the arbitration issue until after filing cross-claims, participating in discovery, and going to trial on the merits constituted waiver of its right to arbitrate. *Id.* The court did not discuss its authority for reaching the waiver issue—possibly because the defendant had neither sought a stay under § 3, nor petitioned the court to compel arbitration under § 4. *Id.* Yet in all of the cases cited in *Demsey*,

except *Chatham*, the court decided the waiver issue only where a defendant, deep into the litigation, sought a stay of judicial proceedings under § 3 of the FAA. *Id.* at 1017-18.[11]

Any distinction between § 3 and § 4 actions—never fully explicated—submerged even more deeply by the time this court decided *Sweater Bee by Banff, Ltd. v. Manhattan Industries, Inc.*, 754 F.2d 457 (2d Cir.), *cert. denied*, 474 U.S. 819 (1985). That case involved a defendant who, only after obtaining an adverse ruling on a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, sought both a § 3 stay and a § 4 order compelling arbitration. 754 F.2d at 459. Citing *Demsey*, we stated that "[t]he rule of this circuit . . . is that the litigation of substantial issues going to the merits may constitute a waiver of arbitration," *id.* at 461, and proceeded to decide the waiver issue. Shortly thereafter, we faced a similar case involving a defendant who sought to sever certain claims from ongoing litigation and petitioned the court to compel arbitration of those claims under § 4 of the FAA. *Rush v. Oppenheimer & Co.*, 779 F.2d 885, 886 (2d Cir. 1985). We made it clear that "waiver of the right to compel arbitration due to participation in litigation may be found only when

[11] *Demsey* cited the following cases: *Carcich v. Rederi A/B Nordie*, 389 F.2d 692 (2d Cir. 1968) (holding no waiver where defendant moved for § 3 stay after participating in discovery and pretrial conferences); *Robert Lawrence*, 271 F.2d 402 (holding no waiver where defendant moved for § 3 stay in the answer); *Reynolds Jamaica Mines, Ltd. v. La Societe Navale Caennaise*, 239 F.2d 689 (4th Cir. 1956) (in what was arguably a § 3 action, finding no waiver and dismissing federal lawsuit because dispute was arbitrable—but not ordering arbitration); *Hilti, Inc. v. Oldach*, 392 F.2d 368 (1st Cir. 1968) (holding no waiver where defendant moved for § 3 stay eight months after raising arbitrability as a defense in answer); *Mason v. Stevensville Golf & Country Club, Inc.*, 292 F. Supp. 348 (S.D.N.Y. 1968) (Pollack, J.) (finding no waiver where defendant sought § 3 stay after failing to object to scheduling of trial).

prejudice to the other party is demonstrated," *id.* at 887, and again decided the waiver issue. Finally, in *Kramer v. Hammond*, 943 F.2d 176 (2d Cir. 1991), we held that a party bringing a petition to compel under § 4 had waived his right to arbitration by engaging in prior litigation in state courts, not in the district court.[12] *Id.* at 180. Again, the parties did not raise and we did not discuss why this issue was for the courts rather than the arbitrators to resolve.

It would appear that the waiver defense has slowly been transformed from a statutorily mandated inquiry in § 3 cases—whether the "applicant for the stay is . . . in default in proceeding with such arbitration"—into a broader equitable defense in § 4 cases. This trend has its

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[12] Prior to our decision in *Kramer*, all of the cases in which we reached the issue of waiver involved substantial litigation on the merits in the district court which was asked to grant the § 3 stay, not in other state or federal courts. Our decisions to rule on the waiver issue, rather than to refer the question to the arbitrators, could have been explained as exercises of the federal courts' inherent power to deal with abusive litigation practices in their courtrooms. *See, e.g., Chambers v. Nasco*, 501 U.S. 32, 44-45 (1991) ("A primary aspect of [a court's] discretion [to exercise its inherent powers] is the ability to fashion an appropriate sanction for conduct which abuses the judicial process."); *Link v. Wabash R.R.*, 370 U.S. 626, 629 (1962) ("The authority of a federal trial court to dismiss a plaintiff's action with prejudice because of his failure to prosecute cannot seriously be doubted."); *Landis v. North Am. Co.*, 9 U.S. 248, 254 (1936) ("[T]he power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants."); *United States v. Hudson*, 7 Cranch 32, 34 (1812) (holding that the inherent powers of federal courts are those which "are necessary to the exercise of all others."). In *Kramer*, however, we reached the question of waiver even though the petitioner had not engaged in prior litigation in the district court. Our precedent therefore teaches that a court's ability to reach the question of waiver as a defense to arbitration is not grounded solely in its ability to control litigation practices before it. In light of *Kramer*, we are bound to hold that a district court may reach the question of waiver whenever a party seeking arbitration has engaged in any prior litigation.

limits, however, and another of our decisions suggests how the equitable waiver defense may be reconciled with our holdings in *World Brilliance*. In *Prudential Lines, Inc. v. Exxon Corp.*, 704 F.2d 59 (2d Cir. 1983), we reaffirmed the holdings of *World Brilliance* and *Trafalgar* that a waiver defense, like a laches defense, was "an arbitrable issue." *Id.* at 67. We noted that in the cases where the court itself decided the issue of waiver, the "party had previously participated in court proceedings to litigate the same dispute." *Id.* at 67 n.8. We therefore distinguished between cases where the waiver defense was based on prior litigation by the party seeking arbitration—when the court should decide the issue of waiver—and those when the defense was based on other actions. It may be that the modern evolution of our waiver doctrine does not correspond precisely to our understanding of the FAA thirty years ago. Yet we are bound to abide by our most recent precedent. *Cf. Commodity Futures Trading Commission v. Dunn*, 58 F.3d 50, 54 (2d Cir. 1995) (holding that a panel of Court of Appeals may not "disregard the reasoning of a decision [of a prior panel] because an entirely different line of reasoning was available").

Clearly, the present case falls squarely within the parameters of *Kramer v. Hammond*, where the party invoking arbitration (DAI) was allegedly involved in prior litigation in state courts. Pursuant to the distinction we drew in *Prudential Lines*, and consistent with *Kramer*, we hold that the issue of DAI's waiver of arbitration is for the district court to resolve on remand. To do so, the court must evaluate the franchisees' factual contentions, including whether the leasing companies were mere alter egos of DAI. If DAI was responsible for the eviction proceedings, the court must then determine

whether prosecution of those eviction actions constituted litigation of "substantial issues going to the merits," *Sweater Bee*, 754 F.2d at 461. This inquiry will require a determination of whether, in fact, the particular eviction proceedings were based on the cross-default provisions of the subleases. If the alleged violations of the subleases were premised on violations of the franchise agreement (which DAI was contractually bound to resolve through arbitration) then DAI did litigate substantial issues going to the merits, and the only remaining question will be whether the franchisees suffered prejudice from the eviction proceedings. *See, e.g., Cotton v. Slone*, 4 F.3d 176 (2d Cir. 1993) (finding prejudice where defendant failed to pursue interlocutory appeal from denial of motion to compel, and instead fully litigated arbitrable issues on the merits in the district court); *Com-Tech Assocs. v. Computer Assocs. Int'l, Inc.*, 938 F.2d 1574, 1576-77 (2d Cir. 1991) (finding prejudice where defendant's extensive litigation before raising issue of arbitration forced plaintiffs to litigate arbitrable claims, and caused considerable expense and delay).

Accordingly, we reverse the district court's order rejecting the franchisees' waiver argument, and remand for further proceedings.

3. *Fraudulent Misrepresentation*

The franchisees argue that DAI fraudulently misrepresented to them that arbitration was a condition precedent to the institution of legal action by either party to the franchise agreement. They argue that DAI had, in reality, reserved the right to bring summary eviction actions against the franchisees through its leasing companies. The franchisees also claim that DAI failed to disclose that it had a custom and practice of bringing

summary eviction proceedings and other legal proceedings for alleged violations of the franchise agreement. The district court held that these allegations would be pertinent only if the leasing companies[13] were indeed DAI's alter egos. Both the alter-ego and fraudulent-inducement issues, the court concluded, should properly be left to the arbitrators. This was error.

In *Prima Paint*, 388 U.S. at 403-04, the Supreme Court stated that "if the claim is fraud in the inducement of the arbitration clause itself—an issue which goes to the 'making' of the agreement to arbitrate—the federal court may proceed to adjudicate it." *See also Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n.14 (1974) (citing *Prima Paint* for the proposition that "an arbitration or forum-selection clause in a contract is not enforceable if the *inclusion of that clause in the contract* was the product of fraud or coercion"). As this court has explained, if the "arbitration clause was induced by fraud, there can be no arbitration; and if the party charging this fraud shows there is substance to his charge, *there must be a judicial trial of that question* before a stay can issue." *Robert Lawrence*, 271 F.2d at 411.

The franchisees allege that they were fraudulently induced to assent to the arbitration clause—not to the rest of the contract. Accordingly, under *Prima Paint*, the district court had to reach the fraudulent inducement issue before deciding whether to compel arbitration. Resolution of the fraud issue, in turn, will require an answer to the antecedent question of whether the leasing companies were DAI's alter egos.

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[13] Although the district court actually referred to the "development agents" as being possible alter egos of DAI, it seems to have meant the "leasing companies." The franchisees do not allege that DAI's various development agents (who engaged in some negotiations on behalf of DAI with the franchisees) were DAI's alter egos.

We therefore reverse the district court's determination that the arbitrators rather than the court should decide the alter-ego and fraudulent-inducement questions. On remand, the district court must resolve these issues.

III. CONCLUSION

To summarize:[14]

1. We affirm the district court's decision that it had subject matter jurisdiction over all of DAI's petitions to compel arbitration, because there was complete diversity between the parties to the arbitration clause.

2. We reverse the district court's holding that the Alabama court's judgment in the *McCrary* case (Case # 8) was not entitled to full faith and credit. That judgment had preclusive effect under Alabama law, and thus barred DAI from seeking to enforce its arbitration agreement with McCrary. We therefore reverse the district court's denial of franchisee McCrary's motion to dismiss DAI's motion to compel and its order granting DAI's petition to compel McCrary to arbitrate. In the exercise of our pendent appellate jurisdiction, we vacate the preliminary injunction barring McCrary from pursuing his Alabama state court claims against DAI. We direct the district court, on remand, to dismiss with prejudice DAI's motion to compel McCrary to arbitrate.

3. We affirm the district court's holding that the Illinois courts' judgments in Cases ## 1-6, 15-16, and *DAI v. Bickel* were still subject to appeal, and thus under Illinois law were not entitled to preclusive effect. We

[14] For the list of cases affected by our ruling, *see supra* note 2.

therefore affirm the district court's denial of those franchisees' motions to dismiss.

4. We affirm the district court's holding that the North Carolina judgment in the *Johnson* case (Case # 7) was not entitled to full faith and credit. That judgment would not be accorded preclusive effect under North Carolina law, because the court's written order does not indicate what issues were actually decided. We therefore affirm the district court's denial of the Johnson franchisees' motion to dismiss.

5. We affirm the district court's holding that "mutuality" was not at issue, but on different grounds. We hold that where consideration supports a contract as a whole, an arbitration clause in that contract is not void for lack of consideration.

6. We reverse the district court's holding that DAI did not waive its right to petition to compel arbitration, and remand for further proceedings. We hold that if the leasing companies were mere alter egos of DAI, their pursuit of eviction proceedings based on violations of the franchise agreements could constitute waiver of DAI's right to demand arbitration.

7. We reverse the district court's decision to defer to the arbitrators on the question of whether DAI fraudulently induced the franchisees to enter into the arbitration agreement. On remand, the district court must decide this issue.

8. Because the district court should have decided the alter-ego, waiver and fraudulent-inducement issues, we reverse its order granting DAI's motion to compel arbitration in all cases and remand for further proceedings. We also reverse its entry of preliminary injunctions

against all of the franchisees—including, in the exercise of our pendent appellate jurisdiction and in the interests of judicial economy, the Alabama franchisees.

9. Finally, because we reverse the district court's orders entering the preliminary injunctions, we need not address the franchisees' contention that those orders violated the Anti-Injunction Act.

September 28, 1995

ORDER

IT IS HEREBY ORDERED that the opinion filed on September 12, 1995, be amended as follows:

Slip op. at 7162, line 30 from top: Insert footnote 13 after "remand."

Slip op. at 7162, bottom of page: Insert "[13]By so holding, we do not purport to reach the question of *how* the district court should resolve this issue. The defendants' jury demands should be considered by the district court in the first instance."

Slip op. at 7162, lines 30-31 from top: Delete "To do so, the court must evaluate the franchiees" and insert "The"

Slip op. at 7162, line 32 from top: Delete ", including" and insert "to be resolved include"

Slip op. at 7162, line 34 from top: Delete "the court must then determine" and insert "it must then be determined"

Slip op. at 7164, line 4 from top: Change footnote number from 13 to 14.

Slip op. at 7164, bottom of page: Change footnote number from 13 to 14.

Slip op. at 7165, line 3 from top: Insert footnote 15 after "questions."

Slip op. at 7165, bottom of page: Insert "[15]*See supra* note 13."

Slip op. at 7165, line 6 from top: Change footnote number from 14 to 16.

Slip op. at 7165, bottom of page: Change footnote number from 14 to 16.

IT IS SO ORDERED:
FOR THE COURT.

GEORGE LANGE III, Clerk

November 1, 1995

Appeal No. 95-7183

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by the appellant Raymond and Sandra Bickel.

> Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED.**

It is further noted that the suggestion for hearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By:_____
Beth J. Meador

November 14, 1995

Appeal No. 94-9207

A petition for rehearing containing a suggestion that the action be reheard in banc having been filed herein by the appellant Emily Distajo, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By:_____
Beth J. Meador
Administrative Atty.

9 U.S.C. § 3

Stay of proceedings where issued therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

9 U.S.C. § 4

Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being

satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

28 U.S.C. § 1738

State and Territorial statutes and judicial proceedings; full faith and credit

The Acts of the legislature of any State,

Territory, or Possession of the United States, or copies thereof, shall be authenticated by affixing the seal of such State, Territory or Possession thereto.

The records and judicial proceedings of any court of any such State, Territory or Possession, or copies thereof, shall be proved or admitted in other courts within the United States and its Territories and Possessions by the attestation of the clerk and seal of the court annexed, if a seal exists, together with a certificate of a judge of the court that the said attestation is in proper form.

Such Acts, records and judicial proceedings or copies thereof, so authenticated, shall have the same full faith and credit in every court within the United States and its Territories and Possessions as they have by law or usage in the courts of such State, Territory or Possession from which they are taken.

735 ILCS 5/2-619(a)(3) and (b)
Involuntary dismissal based upon certain defects or defenses

§ 2-619. Involuntary dismissal based upon certain defects or defenses.

(a) Defendant may, within the time for pleading, file a motion for dismissal of the action or for other appropriate relief upon any of the following grounds. If the grounds do not appear on the face of the pleading attacked the motion shall be supported by affidavit:

* * *

(3) That there is another action pending between the same parties for the same cause.

* * *

(b) A similar motion may be made by any other party against whom a claim is asserted.

ILLINOIS SUPREME COURT RULE 20(a) and (b)

Rule 20. Certification of Questions of State Law from Certain Federal Courts

(a) Certification. When it shall appear to the Supreme Court of the United States, or to the United States Court of Appeals for the Seventh Circuit, that there are involved in any proceeding before it questions as to the law of this State, which may be determinative of the said cause, and there are no controlling precedents in the decisions of this court, such court may certify such questions of the laws of this State to this court for instructions concerning such questions of State law, which certificate this court, by written opinion, may answer.

(b) Contents of Certification Order. A certification order shall contain:

(1) the questions of law to be answered; and

(2) a statement of all facts relevant to the questions certified and showing fully the nature of the controversy in which the questions arose.

ILLINOIS SUPREME COURT RULE 272

Rule 272. When Judgment is Entered.

If at the time of announcing final judgment the judge requires the submission of a form of written judgment to be signed by the

judge or if a circuit court rule requires the prevailing party to submit a draft order, the clerk shall make a notation to that effect and the judgment becomes final only when the signed judgment is filed. If no such signed written judgment is to be filed, the judge or clerk shall forthwith make a notation of judgment and enter the judgment of record promptly, and the judgment is entered at the time it is entered of record.

ILLINOIS SUPREME COURT RULE 304(a)

Rule 304. Appeals from Final Judgments That Do Not Dispose of an Entire Proceeding

(a) Judgments As to Fewer Than All Parties or Claims -- Necessity for Special Finding. If multiple parties or multiple claims for relief are involved in an action, an appeal may be taken from a final judgment as to one or more but fewer than all of the parties or claims only if the trial court has made an express written finding that there is no just reason for delaying either enforcement or appeal or both. Such a finding may be made at the time of the entry of the judgment or thereafter on the court's own motion or on motion of any party. The time for filing a notice of appeal, the entry of the required finding shall be treated as the date of the entry of final judgment. In the absence of such a finding, any judgment that adjudicates fewer than all the claims or the rights and liabilities of fewer than all the parties is not enforceable or appealable and is subject to revision at any time before the entry of a judgment adjudicating all the claims, rights, and liabilities of all the parties.

(P) 95-1086

Supreme Court, U.S.
FILED
JAN 2 1996
CLERK

No. _____

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1995

EMILY DISTAJO, et al.,

Petitioners,

v.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

Petition for a Writ of Certiorari
to the United States Court of
Appeals for the Second Circuit

SUPPLEMENTAL APPENDIX

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January 2, 1996

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POINT VII: THE DISTRICT COURT ERRED BY FAILING TO ABSTAIN FROM EXERCISING JURISDICTION

SEPTEMBER 29, 1994 ORDER RULING ON PENDING MOTIONS, DENYING DAI'S MOTION FOR A PRELIMINARY INJUNCTION, DENYING DAI'S MOTION FOR A HEARING, ON THE PETITIONERS TO COMPEL ARBITRATIONS, DENYING THE MOTIONS OF THE DEFENDANTS TO DISMISS AND ORDERING THAT ANY RESPONSIVE PLEADINGS TO THE PETITIONS TO COMPEL ARBITRATION BE FILED BY OCTOBER 14, 1994

RULING ON PENDING MOTIONS

Plaintiff filed a petition to compel arbitration pursuant to the Federal Arbitration Act (FAA) 9 U.S.C. § 4, and subsequently an application for a Temporary Resisting Order and a Preliminary Injunction. Defendants have filed various motions to dismiss, to transfer and for a hearing on the matter.

BACKGROUND

Plaintiff, Doctor's Associates, Inc. (DAI) is the national franchisor of "Subway" sandwich shops, and is a Florida corporation. DAI entered into written franchise agreements with defendants, permitting them to operate a Subway restaurant. The agreements contain an arbitration clause (paragraph 10c) which reads as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceeding by an aggrieved party to settle disputes arising out or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

Defendants have filed suit against plaintiff, affiliated individuals and

entities in various state courts. Plaintiff demanded arbitration of defendants' claims by the American Arbitration Association in accordance with the arbitration clause. Defendants have refused to arbitrate, and therefore plaintiff petitioner here for an order directing defendants to arbitrate. Plaintiff moved for a temporary restraining order and for a preliminary injunction to stay the state court proceedings until this court could rule on the petitions to compel arbitration. On September 13, 1994 a hearing was held as to whether a preliminary injunction should enter. The temporary restraining order has expired.

DISCUSSION

1) Motions for a Hearing

Plaintiff's motions for a hearing on the petition to compel arbitration and on the motions to dismiss are denied.

2) Motions to Dismiss

A motion to dismiss under Rule 12(b)(6)

must be decided solely on the facts alleged. Goldman v. Belden, 754 F.2d 1059, 1065-66 (2d Cir. 1985). such a motion should be granted only where no set of facts consistent with the allegations could be proven entitling plaintiffs to relief. Conley v. Gibsen, 355 U.S. 41, 45-46 (1957). The issue is not whether plaintiffs will prevail, but whether they should be afforded the opportunity to offer evidence to prove their claims. Id.

A) Local Rule 9

The motion to dismiss filed in 3:94cv00370 Doctor's Associates v. Smith (doc. #5) and 3:94cv00369 Doctor's Associates v. Gillon (doc. #7) are denied for failure to file an accompanying memorandum of law as required by Local Rule 9.

B) Subject Matter Jurisdiction

Several of the defendants claim that this court does not have jurisdiction over

the subject matter of the action because there is not complete diversity, as certain development agents of DAI doing business in the same states that defendants reside must be joined as plaintiffs in the various actions.[1] However, they are not parties to

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[1] Defendants in 3:94cs00515 Doctor's Associates v. Youmaran, 3:94cv00803 Doctor's Associates v. Brenes, 3:94cv00514 Doctor's Associates v. Guerro, 3:94cv00516 Doctor's Associates v. Shino, 3:94cv00517 Doctors Associates, Inc. v. Loenneke. 3:94cv00349 Doctor's Associates v. Distajo, 3:84cv1457 Doctor's Associates Papaleo and Doctor's Associates v. Rothmund are residents of Illinois. They allege that Phil Mesi and Subway Development of Chicagoland, Inc., both development agents of DAI and residents of Illinois are indispensable parties under Red.R.Civ.P. 19(b). Defendants in 3:94cv00998 Doctor's Associates v. Kane are residents of Massachusetts. They allege that Michael and Jane Eslinger and Jams, Inc., development agents of DAI and residents of Massachusetts, are indispensable parties. Defendant in 3:94cv00803 Doctor's Associates v. Johnson is a resident of North Carolina. He alleges that Peter Slomianyj and North Carolina Subway Group, development agents of DAI and resident of North Carolina are indispensable parties. Defendant in 3:94cv1108 Doctor's Associates v. Giannini is a resident of Pennsylvania. He alleges that J.B. Jung and Subway Development

the contract that is at issue int he instant action. "Fed.R.Civ.P 19 does not require the joinder of parties merely because they played some part in the underlying events of a dispute, but only if such parties are necessary in order to grant complete relief or if they would be prejudiced by not being joined." Argo Partners, Inc. v. Littlefield, Adams & Co., 1994 WL 320616 (S.D.N.Y.). "Under the Arbitration Act, an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." Moses H. Cone

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Corporation of Philadelphia, development agents of DAI and residents of Pennsylvania are indispensable parties. Defendants in Doctor's Associates v. McCrary, Doctors Associates v. Gillon, Doctor's Associates v. Smith, Doctor's Associates v. Riise, and Doctor's Associates v. Benton are residents of Alabama. They allege that Bernardo Frausto and Subway Development of Northern Alabama, development agents for DAI and residents of Alabama are indispensable parties.

Hospital v. Mercury Construction Corp., 460 U.S. 1, 20 (1983). See also Steinberg & Lyman v. Takacs, 774 F.Supp. 885 (S.D.N.Y. 1991) (parties to an arbitration agreement must arbitrate even though there are other defendants to the action). There would be no prejudice to the various development agents by not joining them, as they are not parties to the agreement in question and the underlying litigation would proceed as to those parties even if the litigation as to Doctor's Associates and the defendants in this action was stayed. This action to enforce an agreement by the defendants to arbitrate does not require joinder to the additional parties. The motions to dismiss in 3:94cv00349 Doctor's Associates v. Distajo (doc. #s 31, 33, 35, 37, 39 and 46) are denied in their entirety as they relate solely to this issue of subject matter jurisdiction.

C) Personal Jurisdiction/Venue

Defendants contend that this court lacks personal jurisdiction over them and that venue is not proper.[2] These arguments are without merit. In accordance with the arbitration agreement, defendants "subjected [themselves] in advance, to the jurisdiction of the court within whose territorial jurisdiction the arbitration proceedings are to be had . . . ." Hatzlachh Supply Inc. v. Moishe's Electronics, Inc., 848 F.Supp. 25 (S.D.N.Y. 1994); Farr & Co. v. Cia Intercontinental De Navegacion De Cuba, 243 F.2d 342, 346 (2d Cir. 1957). The arbitration agreement also includes a choice

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[2]Defendants assert this argument in the following cases:
3:94cv00515 Doctor's Associates v. Youmaran
3:94cv00998 Doctor's Associates v. Kane
3:94cv00514 Doctor's Associates v. Guerro
3:94cv00803 Doctor's Associates v. Brenes
3:94cv01108 Doctor's Associates v. Gianni
3:94cv00516 Doctor's Associates v. Shino
3:94cv00517 Doctor's Associates v. Loenneke
3:94cv00349 Doctor's Associates v. Distajo
3:94cv00803 Doctor's Associates v. Johnson

of forum clause, stating that the parties are to settle any disputes in Connecticut Such advance consent waives any objection to personal jurisdiction and venue.

D) Abstention

Defendants contend, in a conclusory manner, that this court should decline to exercise jurisdiction over the matter under the doctrine of abstention, citing Colorado River Water Conservation District v. United States, 424 U.S. 800, 813-17 (1976).[3]

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[3]The following defendants assert this argument:
3:94cv00151 Doctor's Associates v. Youmaran (doc. #4)
3:94cv00803 Doctor's Associates v. Brenes (doc. #4)
3:94cv00514 Doctor's Associates v. Guerro (doc. #4)
3:94cv00516 Doctor's Associates v. Shino (doc. #6)
3:94cv00517 Doctor's Associates v. Loenneke (doc. #5)
3:94cv00349 Doctor's Associates v. Distajo (doc. #18)
3:94cv00998 Doctor's Associates v. Kane (doc. #3)
3:94cv01108 Doctor's Associates v. Gianni (doc.#4)

Federal courts generally do not dismiss proceedings merely because the circumstances will compel a federal court to relinquish jurisdiction due to parallel proceedings in state court. Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1 13-14 (1983). Defendants claim that proceedings in over nine cases in state court constitute compelling circumstances. There is nothing remarkable about parallel state litigation. Although it is not entirely clear how extraordinary the circumstances must be in order for the court to decline to exercise its jurisdiction in this context, it is clear that parallel proceedings alone is not sufficient. See Id.; Erwin Chmreinsky, Federal Jurisdiction at 669 (4th Ed. 1989) (listing cases in which courts abstained due to varying circumstances). Defendants have not enumerated exceptional circumstances that arrant dismissal in deference to the state court litigation.

E) Res Judicata and Collateral Estoppel

Defendant in Doctor's Associates v. Johnson alleges that res judicata or collateral estoppel precludes jurisdiction here over the matter because the Northern Carolina trial court in which a complaint was filed declined to stay the lawsuit. These orders are on appeal, and therefore they do not constitute a final judgment on the merits. Therefore res judicata does not apply. See Allen v. McCurry, 449 U.S. 90, 94 (1980). Collateral estoppel applies only to issues decided finally in another forum. Jim Beam Brands Co. v. Crawford, Ltd. 937 F.2d 729, 734 (2d Cir. 1991, Even if these orders were to be considered final, a denial of a motion to stay does not preclude a petition to compel arbitration pursuant to § 4 of the FAA. See In re Pahlberg Petition, 131 F.2d 968, 969 (2d Cir. 19).

Defendants in Doctor's Associates v. McCrary allege that an Alabama state court

had determined the arbitration clause to be void and unenforceable and therefore these issues may not be relitigated in this forum. There is currently pending amotion to reconsider the judgment in the state court. Consequently, there is not a final judgment, as discussed above and the doctrines of res judicata and collateral estoppel do not apply.

4) Motion for Preliminary Injunction

Plaintiffs move for a preliminary injunction to enjoin defendants from moving forward with their respective cases in state court. Defendant claims that this court cannot grant the relief requested under the provisions of U.S.C. § 2283 (the "Anti-Injunction Act").

The Anti-Injunction Act was promulgated to balance the tensions between state and federal courts in a dual system, eliminating inevitable friction that may occur when both state and federal courts entertain

proceedings. As the Supreme Court had noted, state proceedings "should normally be allowed to continue unimpaired by intervention of the lower federal courts, with relief from error, if any through the state appellate courts and ultimately this Court." Atlantic Coast Line R. Co. v. Locomotive Engineers, 398 U.S. 281, 287 (1970).

Injunctions can issue against state proceedings in certain limited situations, "namely, when expressly authorized by statute, necessary in aid of the court's jurisdiction, or necessary to protect or effectuate the court's judgment." Chick Kam Choo v. Exxon Corp., 486 U.S. 140, 146 (1988). The exceptions are narrow and "'not [to] be enlarged by loose statutory construction.'" Id. (quoting Atlantic 398 U.S. at 146). As there is neither statutory authority for entry of an injunction nor a judgment which the court seeks to

effectuate, the question is whether this court can enjoin the state proceedings in aid of its jurisdiction.

In the present action, the state and federal court have concurrent jurisdiction and consequently neither court is "free to prevent either party from simultaneously pursuing claims in both courts." Atlantic 398 U.S. at 295.

> Each court is free to proceed in its own way and in its own time, without reference to the proceedings in the other court. Whenever a judgment in rendered in one of the courts and pleaded in the other, the effect of that judgment is to be determined by application of the principles of res judicata.

Vendo Co. v. Lektro-Vend Corp., 433 U.S. 623, 642 (1977). Additionally, the Supreme Court has limited the "in aid of jurisdiction" exception only to cases in which a federal court acquired jurisdiction over real property, but had not extended it to proceedings involving in personam jurisdiction. Atlantic 398 U.S. at 295-96.

As the state court proceedings do not impair this court's jurisdiction to proceed, and there is not dispute as to real property, an injunction is not appropriate.

Exceptions to the Anti-Injunction Act recognized in the Second Circuit also do not apply to the present situation. The Act has been found not to apply when state court proceedings have not been instituted. Standard Microsystems v. Texas Instruments, 916 F.2d 58, 61 (2d Cir. 1990). However, each of the consolidated cases have pending litigation in a state court, and the act bars "an injunction to stay proceedings in a state court." 28 U.S.C. § 2283 (emphasis added). The Second Circuit has cast doubt as to the validity of another exception formulated in the Seventh Circuit in Barancik Investors Funding Corp., 489 F.2d 933 (7th Cir. 1973), which allowed an injunction if the state court proceedings were instituted after a motion was filed to

enjoin it, but before the court ruled on it. See Standard Microsystems, 916 F.2d at 61. The facts here do not support such an argument as the state court litigation was commenced prior to plaintiff's application for preliminary injunction.

The motion for a preliminary injunction (doc. #59) is denied as the action does not fall within any of the narrow exceptions to the Anti-Injunction Act. According, defendants' motions to file responsive pleadings in state court are granted.

Conclusion

The following motions to dismiss are denied:

3:94cv00349 Doctor's Associates v. Distajo (doc. #s 4, 18, 31, 33, 35, 37, 39, 46, 53, 84, 86, 89)
3:94cv00369 Doctor's Associates v. Gillon (doc. #7)
3:94cv00370 Doctor's Associates v. Smith (doc #5)
3:94cv00511 Doctor's Associates v. Brenes (doc. #4)
3:94cv00514 Doctor's Associates v. Guerro (doc. #4)
3:94cv00515 Doctor's Associates v. Youmaran (doc. #4)
3:94cv00516 Doctor's Associates v. Shino (doc. #6)

3:94cv00517 Doctor's Associates v. Loenneke (doc. #5)
3:94cv00803 Doctor's Associates v. Kane (doc. #3)
3:94cv01108 Doctor's Associates v. Gianni (doc. #4)
3:94cv1457 Doctor's Associates v. Papaleo (doc. #5)

The following motions for hearing are denied:
3:94cv00349 Doctor's Associates v. Distajo (doc. # 21 & 50)
3:94cv00354 Doctor's Associates v. McCrary (doc. #9)
3:94cv00369 Doctor's Associates v. Gillon (doc. #9)
3:94cv00370 Doctor's Associate v. Smith (doc. #8)
3:94cv00371 Doctor's Associates v. Riise (doc. #10)
3:94cv00372 Doctor's Associates v. Benton (doc. #8)
3:94cv00511 Doctor's Associates v. Brenes (doc. #8)
3:94cv00514 Doctor's Associates v. Guerrero (doc. #8)
3:94cv00515 Doctor's Associates v. Youmaran (doc. #8)
3:94cv00516 Doctor's Associates v. Shino (doc. #7)
3:94cv00517 Doctor's Associates v. Loenneke (doc. #8)

The following motions to file documents in pending state proceedings are granted. Doctor's Associates v. Distajo, 3:94cv00349 (doc. #s 72, 73, 74, 77, 78, 79, 80) The Motion for leave to file a supplemental

memorandum of law in support of the motion to dismiss for lack of venue 3:94cv00511 Doctor's Associates v. Brenes (doc. #7) is granted, and was considered. The motion to transfer venue, Doctor's Associates v. Distajo 3:94cv00349 (#8), is denied. The motion for preliminary injunction Doctor's Associates v. Distajo 3:94cv00349 (#59) is denied.

Any responsive pleadings to the petitioner to compel arbitration shall be filed on or before October 14, 1994. The petitioner shall be decided on the record as of that date.

SO ORDERED.

Dated an New Haven, Connecticut, this 29th day of September, 1994.

Peter C. Dorsey
United States
District Judge

NOVEMBER 10, 1994 ORDER COMPELLING DEFENDANTS TO ARBITRATE IN ALL 16 CASES & DISMISSING THE CONSOLIDATED CASE, WITHOUT PREJUDICE TO EITHER SIDE TO REOPEN AS NECESSARY

RULING ON PETITIONS TO COMPEL ARBITRATION

Plaintiff seeks to compel arbitration pursuant to the Federal Arbitration Act (FAA) 9 U.S.C. §4. Defendants have raised various defenses.

Background

Doctor's Associates, Inc. (DAI) the national franchisor of "Subway" sandwich shops, is a Florida corporation. DAI entered into written franchise agreements with defendants, permitting them to operate Subway shops. The agreements contain an arbitration clause (paragraph 10c) which reads:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be

> entered in any Court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out or to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

Defendants have sued plaintiff, affiliated individuals and entities in various state courts. Plaintiff demanded arbitration of defendants' claims by the American Arbitration Association in accordance with the arbitration clause. Defendants have refused to arbitrate. Plaintiff petitions here for an order that defendants arbitrate. Defendants have filed various motions to dismiss, which were denied. Plaintiff moved for a preliminary injunction to stay state court litigation pending a decision or this case, which was denied.

Discussion

Section 4 of the FAA enables a party to seek in federal courts an order that a party arbitrate a dispute. An action may be

brought by "[a] party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration." A court must order arbitration if it is "satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue." Id. A court must conduct a limited review to determine whether a valid agreement to arbitrate exists and if the dispute falls within the scope of that agreement. AT & T Technologies v. Communications Workers of America, 475 U.S. 643, 649 (1986). If the court "determines that an agreement exists and that the dispute falls within the scope of the agreement, it then must refer the matter to arbitration without considering the merits of the dispute. Painewebber, Inc. v. Hartmann, 921 F.2d 507, 511 (3d Cir. 1990).

Defendants do not dispute the written agreement but they argue that they are not

obligated to participate in arbitration. They allege that a valid agreement as to arbitration does not exist for lack of mutuality, fraudulent misrepresentation, waiver, unconscionability, that the clause is a contract of adhesion, and for unfair trade practices pursuant to the Federal Trade Commission Act, 15 U.S.C. § 45/ They also challenge this court's jurisdiction and venue and invoke res judicata and collateral estoppel. The issues of jurisdiction, venue, res judicata and collateral estoppel were addressed previously and will not be reconsidered.

A) Lack of Mutuality

Defendants contend that the arbitration clause is void for lacks mutuality in that DAI and the franchisee must arbitrate all disputes arising out of or relating to the franchise agreements. See Kroll v. Doctor's Associates, Inc., 3 F.3d 1167, 1171 (7th Cir. 1993). Defendants claim that the

development agents for DAI, acting as DAI's "alter-egos," are a means by which DAI avoids the duty to arbitrate certain disputes arising out of or related to the agreement. They allege that the development agents, wholly owned by DAI, reserve the right to bring summary eviction actions or other legal proceedings. DAI, acting through such agents, thus has the right, de facto, to initiate proceedings other than arbitration. Consequently, defendants argue, there is an issue of lack of mutuality which must be submitted to a jury.

The threshold determination is whether the development agents operating in various states, are indeed the "alter egos" of DAI. This is a matter of law. If it is determined that the agents are not part of DAI, then the arbitration clause will be enforceable only as to DAI and the defendants, obliging them to arbitrate, thus establishing mutuality. If the agents are

determined to be part of DAI then as its "alter egos," the agents also would be obliged under the arbitration clause. Either way, mutuality is not an issue. As the determination of whether agents are "alter egos" of DAI is a matter of law, it is most appropriately left to the decision of the arbitrator.

B) Waiver

Defendants allege that DAI had waived arbitration by virtue of its extensive participation in the various lawsuits. In determining whether a party has waived arbitration, the extent of the party's participation in the lawsuit, its action have been inconsistent with the right to compel arbitration, whether the litigation process has been substantial, any long delay in seeking arbitration, whether movant (in this case, the plaintiff) filed claims without seeking arbitration, whether discovery has occurred, and whether the

other party would be prejudiced by the delay must be considered. See Jones Motor Co. v. Chauffers Teamsters & Helpers Local Union No. 633, 671 F.2d 38, 44 (1st Cir.) cert. denied, 459 U.S. 943 (1982).

In the state court actions, the leasing companies invariably commenced eviction proceedings in which franchisees asserted complaints against the leasing companies and DAI. DAI claims that it filed arbitration demands with the FAA and invoked its arbitration rights early in the proceedings. Defendants allege that because the leasing companies are in fact part of DAI, DAI should be held not to have invoked arbitration rights until well into the litigation.

"The rule of this circuit . . . if that the litigation of substantial issues going to the merits may constitute a waiver of arbitration." Sweater Bee By Banff v. Manhattan Industries, 754 F.2d 457, 461 (2d

Cir. 1985). "[N]o waiver can ordinarily be found where a party raises arbitration in its answer and moves promptly for a stay." Id. If the leasing companies are not considered part of DAI, then DAI did indeed invoke their arbitration rights from the beginning of their involvement in the proceedings, and will not be deemed as waiving them. If the leasing companies are to be considered part of DAI, the proceedings commenced by them were related to the leases. The more general questions as to the franchise agreements were raised by franchisees when DAI was brought into the cases. The right to arbitrate the latter dispute was raised when DAI became a party to the suits. As soon as a franchisee named DAI as a party, soon after the commencement of the proceedings, DAI asserted its arbitration rights. It is not penalized for defending a lawsuit after an adverse determination in some cases, or because a

state court has not reached the issues of arbitrability in others. If cannot be held to have waived a right of arbitration by an after-the-fact holding that it is the alter ego of the leasing companies. Accordingly, DAI has not waived its right to arbitration.

C) Fraudulent Misrepresentation

Defendants argue that DAI fraudulently misrepresented that arbitration was a condition precedent to the institution of a legal action by either party to the franchise agreement, but in fact had reserved the right to bring summary eviction actions and other legal proceedings against the franchisees. They also claim that DAI failed to disclose that it had a customer and practice of bringing summary eviction proceedings and other legal proceedings for alleged violations of the Franchise Agreement.

These allegations would be pertinent only if the development agents are

determined to be alter egos of DAI. As indicated previously, this decision is best left to the arbitrator; it will not be considered here.

D) Unconscionable

Defendants allege that the arbitration clause is void and unenforceable because it is unconscionable as it requires defendants, residents or various states, to arbitrate all disputes with plaintiff, a Florida corporation, in Connecticut.

The doctrine of unconscionability prevents oppression and unfair surprise. Edart Truck Rental Corp. v. B. Swirsky & Co., 23 Conn.App. 137, 142 (1990) (citing J. Calamari & J. Perillo, Contracts (3d Ed.) § 9-40). If the clause is unconscionably one-sided under the circumstances existing at the making of the contract, it is unenforceable. Edart, 23 Conn.App. at 142. "[P]laintiff's actions must be weighed against the defendant's business experience,

the business practices of the community, and the relatively equal bargaining power of the parties." Id. at 143. the record as to this issue is sparse, but it is sufficient for the limited determination to be made here. Defendants were not uneducated consumers. See Williams v. Walker-Thomas Furniture Co., 350 F.2d 445, 449 (D.C. Cir. 1965). They were business people investing in a franchise. It is assumed that they reviewed the franchise agreement, including the arbitration clause, prior to signing it. The language was not placed obscurely in fine print. There is no suggestion of DAI's overreaching. What is shown is a clearly stated agreement, openly accepted by defendants. The clause is not unconscionable.

E) Contract of Adhesion

Defendants allege that the arbitration clause is void and unenforceable as a contract of adhesion in that the terms were

not negotiated by the parties, that plaintiff drafted the clause, and that plaintiff was in a dominant position due to its superior economic power. They also allege that the clause did not meet their reasonable expectations, they were not informed that they would be waiving a right to a jury trial and subjects them to large expenses associated with arbitration which are much higher than litigation expenses.

"The hallmark of a contract of adhesion is that its terms 'are not subject to the normal bargaining processes of ordinary contracts.'" Dainty Rubbish Service, Inc. v. Beacon Hill Assn., Inc., 32 Conn. App. 530, 535 (1993) (quoting Aetna Casualty & Surety Co. v. Murphy, 206 Conn. 409, 416 (1988)). There are no allegations that the parties were not able to bargain over this clause in the ordinary course of negotiations. There is no suggestion that defendants did not freely choose to enter the agreements.

Parties were able to negotiate the terms of the arbitration agreement; it is irrelevant that plaintiff drafted the provision and had a superior economic position. Certainly it is not relevant to this claim that plaintiff did not inform defendants of all the ramifications that might or might not materialize due to an agreement with this clause. Accordingly, it is found that the clause is not a contract of adhesion.

F) Federal Trade Commission Act

Defendants argue that the arbitration clause is void and unenforceable as it violates the prohibition against unfair trade practices of the FTCA in that it places a substantial burden and onerous costs on defendant. There is no private right of action under 15 U.S.C. § 45 or the FTC regulations. See American Airlines v. Christensen, 967 F.2d 410, 414 (10th Cir. 1992).

Conclusion

Plaintiff's petition that defendants be ordered to arbitrate their claims under the franchise agreement is granted. This case is referred to arbitration in accordance with the arbitration clause contained in the franchise agreement. Accordingly, the case is dismissed without prejudice to either side to either side to reopen as necessary for the protection or assertion of rights by either side subsequent to the arbitration proceedings.

SO ORDERED.

Dated at New Haven, Connecticut, this 9th day of November, 1994.

Peter C. Dorsey
United States
District Judge

NOVEMBER 22, 1994 DISTRICT COURT ORDER IN THE DISTAJO CONSOLIDATED CASES ENTERING A TEMPORARY RESTRAINING ORDER AGAINST THE DEFENDANTS

TEMPORARY RESTRAINING ORDER

The Court, having heard the parties and having read the reporting affidavit, exhibits and memorandum of law and it appearing that there is likelihood that plaintiff Doctor's Associates, Inc. ("DAI") will suffer immediate, substantial and irreparable harm and injury to its rights under section 4 of the Federal Arbitration Act, 9 U.S.C. § 4, to compel arbitration if defendants' state court actions are not temporarily enjoined, it is hereby

ORDERED, that service of this temporary restraining order and related papers to be made upon defendants' attorneys on or before 23 November, 1994; and it is further

ORDERED that no bond shall be required in the circumstances of this case.

Entered at New Haven, Connecticut, this

22nd of November, 1994 at 1:30 o'clock/p.m.

Peter C. Dorsey
United States District Judge

DECEMBER 9, 1994 ORDER GRANTING DAI'S NOVEMBER 22, 1994 PETITION FOR A PRELIMINARY INJUNCTION, AND ENJOINING THE DEFENDANTS FROM PROCEEDING FURTHER WITH THE 16 STATE COURT ACTIONS, PENDING TO ARBITRATION

(Reported at Doctors's Associates, Inc. v. Distajo, et al. 870 F.Supp. 870 (D.C. Conn 1994).

RULING ON PENDING MOTIONS

After entry of a temporary restraining order prohibiting defendants from pursing various state court actions, a hearing to show cause why a preliminary injunction should not enter was held on November 29, 1994. Defendants[1] move to vacate the

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[1] The following defendants bring this motion:

3:94cv01457 Doctor's Associates v. Papaleo
3:94cv01456 Doctor's Associates v. Rothmund
3:94cv00349 Doctor's Associates v. Distajo
3:94cv00516 Doctor's Associates v. Shino
3:94cv00514 Doctor's Associates v. Guerrero
3:94cv00948 Doctor's Associates v. Kane

temporary restraining order and oppose plaintiff's motion for preliminary injunction.

Background

Doctor's Associates, Inc. (DAI) the national franchisor of "Subway" sandwich shops, is a Florida corporation. DAI entered into written franchise agreement with defendants, permitting them to operate Subway shops. The agreements contain an arbitration clause (paragraph 10c) which reads:

3:94cv01108 Doctor's Associates v. Giannini
3:94cv00803 Doctor's Associates v. Johnson
3:94cv00517 Doctor's Associates v. Loenneke
3:94cv00515 Doctor's Associates v. Youmaran
3:94cv00511 Doctor's Associates v. Brenes

The "Alabama defendants did not join in the motion. They are:

3:94cv00372 Doctor's Associates v. Benton
3:94cv00354 Doctor's Associates v. McCrary
3:94cv00370 Doctor's Associates v. Smith
3:94cv00371 Doctor's Associates v. Riise
3:94cv00369 Doctor's Associates v. Gillon

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such proceeding will be borne equally by the parties.

Defendants have sued plaintiff, affiliated individuals and entities in various state courts. Plaintiff demanded arbitration of defendants' claims by the American Arbitration Association in accordance with the arbitration clause. Defendants have refused to arbitrate. The matter has been ordered to arbitration. Plaintiff has moved to enjoin defendants from proceeding in state court with parallel litigation.

Discussion

A) Res Judicata/Collateral Estoppel

Defendants argue that res judicata and/or collateral estoppel bar this court from deciding the arbitration issue. Specifically, they content that an October 24, 1994 judgment of an Illinois state court[2] prevents relitigation of the issue, as Illinois law recognizes a trial court judgment as final for purposes of res judicata and collateral estoppel.

The full faith and credit statute, 28 U.s.C. § 1738 gives state court judgments the same preclusive affect as given by courts of the forum states. Marrese American Academy of Orthopaedic Surgeons, 470 U.S. 373, 380 (1985). Illinois law thus determines what preclusive effect is to be

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[2]Defendants also cite certain Alabama decisions. Defendants effected by those decisions do not challenge a preliminary injunction. Those decisions will not be discussed here.

given to the October 24, 1994 decision.

Under Illinois law, preclusive effect is given to a final judgment on the merits. Pelon v. Wall, 262 Ill. App.3d 131, 135 (1994). "For res judicata purposes, a judgment is not final until the possibility of appellate review has been exhausted." Id. (citations omitted). Plaintiff has indicated that there is a motion for reconsideration pending in the Illinois case. As that motion is pending, and there is the possibility of appeals, the Illinois judgment does not preclude this court from either acting on the arbitration issue or ordering appropriate measures to effectuate its decisions.

B) Stay of State Court Proceedings

1) Federal Arbitration Act

Defendants first argue that this court cannot stay the underlying state actions pursuant to § 3 of the Federal Arbitration Act (FAA) as that section only allows a

court to stay a case when it has a pending suit before it. As there is no suit currently before the court, it is inappropriate for the court to use this section to stay litigation.

2) Anti-Injunction Act

Federal courts are generally prohibited from staying state court proceedings by the Anti-Injunction Statute, 28 U.S.C. § 2283. However, the statute provides that "[a] court of the United States may not grant an injunction to stay proceedings in judgments." Id. This exception is applicable where "a federal court has made [a] conclusive ruling [] and [its] effect may be undermined by threatened relitigation in state courts." Standard Microsystems v. Texas Instruments, 916 F.2d 58, 60 (2d Cir. 1990).

If has been held here that any dispute as to DAI, in accordance with the agreement, must be addressed in arbitration. Continued

litigation of these issues in parallel state proceedings will undermine, if not moot, this ruling, Further proceedings as to defendants' disputes with DAI, which have been determine not to belong in the courts, but in arbitration, may effect this court's judgment. Necchi Sewing Machine Sales Corp. v. Carl, 260 F.Supp. 665, 669 (S.D.N.Y 1966); see also McGuire, Cornwall & Blakey v. Grider, 765 F.Supp. 1048, 1052 (D.Colo. 1991); Hunt v. Mobil Oil Corp., 557 F.Supp. 368, 372 (S.D.N.Y. 1983).

Defendants have clearly manifested their intent to proceed with state court litigation despite the order of arbitration of their disputes with DAI. This continued action would impair the integrity of the order of arbitration. An injunction is not appropriate.

Conclusion

The motion for preliminary injunction (doc.

#120) is granted; the motion to vacate the temporary restraining order (doc. #127) is denied. Defendants shall be enjoined from proceeding with all related state court litigation pending arbitration.

SO ORDERED.

Dated at New, Connecticut, this 9th day of December, 1994.

Peter C. Dorsey
United States
District Judge

FEBRUARY 13, 1995 ENDORSEMENT GRANTING THE PETITIONER TO COMPEL ARBITRATION

PETITION TO COMPEL ARBITRATION

This is an action to compel arbitration pursuant to Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4.

Handwritten endorsement: February 13, 1995 granted.

Peter C. Dorsey
U.S.D.J.

FEBRUARY 13, 1995 ENDORSEMENT GRANTING THE MOTION FOR PRELIMINARY INJUNCTION

MOTION FOR PRELIMINARY INJUNCTION

Pursuant to Rule 65, Fed. R. Civ. P., and based on the memorandum of law filed herewith, plaintiff Doctor's Associates, Inc. ("DAI") moves for a preliminary injunction enjoining defendants, until further order of this Court, from prosecuting their states action.

handwritten endorsement: February 13, 1995 granted as per record in open court.

Peter C. Dorsey.
U.S.D.J.

FEBRUARY 13, 1995 DISTRICT COURT ORAL ORDER, IN THE BICKEL CASE, WITH RESPECT TO THE PRELIMINARY INJUNCTION

MR. DUNHAM [attorney for DAI]: I'll try to stop short of that. My request is this, and because we have not -- I just found out about this default judgment and I haven't had the change to review the papers, I'm not sure what Doctor's Associates may want to

do, but I would request that the preliminary injunction that you have just entered, enter without prejudice to the right of Doctor's Associates to go to court in Illinois for the limited purpose of vacating the default judgment. I don't know whether we're going to do it. We have to look at Illinois law which -- on this, which we haven't had the opportunity to do yet, but I don't want to get mousetrapped by Mr. Duree and the judge in Madison County here, and I think in fairness that would be appropriate under the circumstances.

THE COURT: All right. Anything else?

MR. DUNHAM: No litigation on the merits whatsoever, simply moving to vacate the default on the grounds that service was improper, and whatever other grounds are available under Illinois law.

THE COURT: All right, what I'll do is I'll endorse the preliminary injunction. what I would suggest is that since that is

not part of the order that you filed, rather than sign that order, Mr. Dunham, what I would suggest is you take it back.

MR. DUNHAM: Fine, we'll amend it.

THE COURT: And redraft and submit a further order following upon my granting of the preliminary injunction, and provided that it's in the form that you have here, plus the additional provision hat you talked about, so that Mr. Wocl is not prejudiced by having something snuck into a preliminary injunction that he didn't know about, and then provide him with a copy of it too, --

MR. DUNHAM: That's fine. We will today prepare a substitute order. We'll fax it to Mr. Wocl's office in Bridgeport so that he can see it this morning and have the opportunity to comment if he so chooses, and then we'll bring it back over to your chambers later today.

THE COURT: All right.

MR. WOCL: [attorney for Defendants]

Your Honor, so your granting this additional request for the limited purpose to vacate the default judgment?

THE COURT: Just for -- well, I'm not going to put it in terms of vacating the judgment. I'm going to permit them to make whatever procedural attack on what has entered, in whatever form they decide to do it. If they decide to move to vacate it, that's fine. If they decide to ignore it, that's up to them to, but the point is that it seems to me that it's not inappropriate even though I preclude any further prosecution of that matter, that I not prejudice them or leave them in a position where they might be prejudiced, but failing to take corrective action, because in following upon your earlier argument, it may be that some court says there is a further obligation to do something other than just leave a default judgment outstanding.

MR. WOCL: I understand that, Your

Honor. I just want to make sure we're on all fours with regard to the parameters of Doctor's Associates --

THE COURT: That [sic] all I have in mind.

MR. WOCL: Okay.

MR. DUNHAM: And that's all we were requesting.

THE COURT: That's what I understand is the request. Anything else Mr. Wocl, that you have any questions about?

MR. WOCL: No, Your Honor.

THE COURT: All right. Anything else I should deal with, Mr. Dunham?

MR. DUNHAM: No, Your Honor.

THE COURT: I'll endorse the motion for preliminary injunction as granted, as per the record in open court here this morning, so that will protect you, Mr. Wocl. It's on the record as to what additional was granted that isn't specifically spelled out, and that will protect you because, you know, my

recollection --

NOTE: THE BICKELS' BRIEF AS APPELLANTS WAS ON FILE BEFORE THE DISTRICT COURT ENTERED THE MAY 9, 1995 FORMAL, WRITTEN PRELIMINARY INJUNCTION

MAY 9, 1995 DISTRICT COURT ORDER IN THE BICKEL CASE, ENJOINING THE DEFENDANTS

ORDER FOR PRELIMINARY INJUNCTION

The Court, having heard the parties, and it appearing that there is a likelihood that plaintiff Doctor's Associates, Inc. ("DAI") will suffer immediate, substantial and irreparable harm and injury to its rights under Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4, if defendants' state court action is not temporarily enjoined, it is hereby

ORDERED that defendants are enjoined until further order of the Court from prosecuting their state action; and it is further

ORDERED that not bond shall be required in the circumstances of this case.

Nothing in this order shall preclude DAI or any of its co-defendants in the matter entitled Raymond and Sandra Bickel v. Subway Sandwich Shops, et al., 94-L-1248 from taking whatever steps are available under applicable Illinois law to vacate, appeal or otherwise challenge any default judgment(s) that have been entered by the Circuit Court of Madison County in that action.

Entered at New Haven, Connecticut, this 9th day of May, 1995.

Peter C. Dorsey
United States District Judge

Supreme Court, U.S.
FILED
MAR 1 1996
CLERK

(3)

No. 95-1086

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

EMILY DISTAJO, et al.,

Petitioners,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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28 pp

QUESTIONS PRESENTED

1. Whether the United States District Court for the District of Connecticut had subject matter jurisdiction, under 28 U.S.C. § 1332, over respondent Doctor's Associates, Inc.'s ("DAI") petitions to compel arbitration pursuant to Section 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. § 4, where there was complete diversity among the parties to each Section 4 action.

2. Whether, in holding that the full faith and credit statute, 28 U.S.C. § 1738, did not bar the District Court from granting DAI's petitions to compel arbitration, the United States Court of Appeals for the Second Circuit correctly concluded that under Illinois law, Illinois courts would not have given preclusive effect to certain rulings by an Illinois trial court that were still subject to appeal.

3. Whether, in holding that the full faith and credit statute, 28 U.S.C. § 1738, did not bar the District Court from granting DAI's petitions to compel arbitration, the Second Circuit correctly concluded that rulings by a North Carolina trial court did not address the validity of DAI's arbitration agreement with the North Carolina petitioner.

4. Whether the District Court correctly decided not to abstain from exercising jurisdiction over DAI's petitions to compel arbitration under the particular facts of this case.

STATEMENT PURSUANT TO RULE 29.6

Doctor's Associates, Inc. states that it has no parent company, and that it has no subsidiaries (other than wholly-owned subsidiaries).

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No. 95-1086

IN THE

Supreme Court of the United States

OCTOBER TERM. 1995

EMILY DISTAJO, et al.,

Petitioners,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

STATUTORY PROVISION INVOLVED

Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4, provides:

> **Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination**
>
> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in

a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233.

STATEMENT OF THE CASE

DAI is the franchisor of "Subway" sandwich shops, and the petitioners are present or former Subway franchisees. Each petitioner entered into a franchise agreement with DAI that contained a virtually identical arbitration provision.[1/] This arbitration agreement provides that any claim arising out of or relating to the franchise agreement must be arbitrated in accordance with the commercial rules of the American Arbitration Association ("AAA").[2/]

When disputes later arose between petitioners and DAI, each petitioner ignored the agreement to arbitrate and sued DAI, its owners, affiliates and local agents in a state court. In each case, DAI promptly filed with the AAA a demand for arbitration in accordance with the arbitration agreement. And in response to each state court lawsuit, DAI filed a petition in the United States District Court for the District of Connecticut (the "District Court") to compel arbitration under Section 4 of

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[1] There are some differences in certain of the arbitration clauses about the site of the arbitration and how the costs of the arbitration are divided between the parties. Those differences are not relevant to the issues raised in the petition.

[2] Each of the arbitration clauses was substantially identical to the following provision:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgement upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. Each party will be responsible for their own costs in conjunction with the arbitration proceeding. If Franchisee commences action in any court prior to an arbitrator's final decision on the controversy or claim, Franchisee will be responsible for all expenses incurred by both the Company and Franchisee in the Arbitration and the Court proceedings.

the FAA. This petition arises from petitioners' steadfast refusal to comply with their contractual obligations to arbitrate their disputes with DAI, and DAI's efforts to enforce those arbitration agreements under the FAA.

1. The events giving rise to this petition began in December 1993 when a group of Subway franchisees filed five lawsuits in the Circuit Court of Madison County, Illinois, against DAI, its owners, agents and affiliates. Counsel for these franchisees -- counsel for petitioners here -- later filed three more lawsuits on behalf of Subway franchisees against DAI and others in the Madison County Circuit Court during the spring and summer of 1994.[3/] During 1993 and 1994 petitioners' counsel also filed lawsuits against DAI on behalf of other Subway franchisees in state courts in North Carolina, Massachusetts and Pennsylvania. At about the same time, a group of five present and former Subway franchisees from Alabama brought actions against DAI in two different Alabama state courts.[4/]

In response to each state court action, DAI promptly filed a demand with the AAA for arbitration. When each franchisee refused to comply with DAI's arbitration demand, DAI filed separate petitions in the District Court to compel arbitration under Section 4 of the FAA. The District Court eventually consolidated those petitions (a total of sixteen) under the caption *Doctor's Associates, Inc. v. Distajo, et al.*[5/]

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[3] To say that these petitioners were "forum-shopping" in filing suit in Madison County would be an understatement: each petitioner in these eight Illinois actions works and lives in metropolitan Chicago, which is about 300 miles away from Madison County; the only Illinois parties in those cases are from the Chicago area; and none of the facts of any of the cases has the slightest connection to Madison County.

[4] The Alabama franchisees have not joined this petition.

[5] Each of DAI's petitions to compel arbitration arises out of a typical dispute between a franchisee and a franchisor, with each franchisee claiming that DAI and its agents breached the franchise agreement and committed various torts and statutory violations.

From the outset, petitioners' strategy was to delay resolution of DAI's Section 4 petitions for as long as possible, in order to seek rulings on arbitrability favorable to petitioners from the state courts before the District Court could compel arbitration.[6] For example, petitioners filed over 20 briefs in the District Court setting forth a series of tenuous arguments challenging the court's authority to hear the case. Among other things, petitioners claimed that the District Court lacked subject matter and personal jurisdiction, that venue was improper, and that the District Court should abstain from hearing the petitions under *Colorado River Water Conservation Dist. v. United States*, 424 U.S. 800 (1976). As a result of petitioners' dilatory tactics, the parties were forced to brief the same issues more than ten times. Petitioners' counsel frankly admitted during a hearing in the Madison County court that the Illinois petitioners were in a "race to the courthouse" and wanted to obtain a ruling from the state court that the Illinois actions were not arbitrable before the District Court could compel arbitration. R. App. 95, ¶ 6.[7]

In one respect, petitioners' efforts to thwart DAI's right to an expedited and summary resolution of its petitions to compel arbitration worked. For on October 24, 1994, over seven months after DAI filed its first Section 4 petition in the District Court, and about two weeks before the District Court ultimately granted those petitions, the Madison County Circuit

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[6] This Court has recognized that the intent of the FAA was to provide for "rapid and unobstructed enforcement of arbitration agreements", *Moses H. Cone Memorial Hosp. v. Mercury Construction Corp.*, 460 U.S. 1, 23 (1983). Section 4 requires an "expeditious and summary hearing, with only restricted inquiry into factual issues," *id.* at 22, and contemplates a decision on arbitrability in "very short order". *Id.* at 22, 23, nn. 26 & 27.

Owing to petitioners' tactics and the District Court's congested docket, however, it became impossible for the court to comply with these statutory mandates. DAI filed its first petition in March 1994, but the court did not issue its decision compelling arbitration until almost eight months later.

[7] "R. App." refers to respondent's Appendix.

Court ruled in the eight Illinois cases that the arbitration clause in the Subway franchise agreement was unenforceable. *See Doctor's Associates, Inc. v. Emily Distajo, et al.*, 66 F.3d 438, 449 (2d Cir. 1995). DAI timely filed a motion for reconsideration, and that motion is still pending before the state court. *Id.*

The North Carolina state court also entered two orders before the District Court could rule on DAI's Section 4 petitions. R. App. 54-60. In the North Carolina action, DAI had filed a motion with the trial court under Section 3 of the FAA to stay the lawsuit brought by petitioner Johnson in favor of arbitration, and a separate motion to dismiss Mr. Johnson's case. In the motion to dismiss, DAI contended that Mr. Johnson waived his right to challenge the arbitration agreement because he had previously participated in an arbitration with DAI. Although the North Carolina trial court summarily denied each motion, it never determined whether the arbitration clause in the Subway franchise agreement was enforceable. R. App. 54-60. Instead, the court merely held that Mr. Johnson had not waived his right to contest the validity of the arbitration clause. R. App. 56, *Distajo*, 66 F.3d at 450-51.[8/]

2. On September 29, 1994 the District Court denied each petitioner's motion to dismiss DAI's Section 4 petition. The Court held that it had subject matter and personal jurisdiction, and that venue was proper. The Court also rejected petitioners' argument that it should abstain from deciding DAI's petitions. Following this Court's decision in *Moses H. Cone*, the District Court recognized that "only exceptional circumstances will compel a federal court to relinquish jurisdiction due to parallel proceedings in state court." R. App. 45, citing *Moses H. Cone*, 460 at 13-14 (1983). The court concluded that petitioners "have not enumerated exceptional circumstances

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[8] In 1994 a trial court in Alabama held that John McCrary, who was also a defendant in *Distajo*, was not required to arbitrate his dispute with DAI. The Second Circuit held that the District Court should have accorded full faith and credit to this judgment of the Alabama trial court, *Distajo*, 66 F.3d at 447-50. That ruling is not an issue in this petition.

that warrant dismissal in deference to the state court litigation":

> Defendants contend, in a conclusory manner, that this court should decline to exercise jurisdiction over the matter under the doctrine of abstention, citing *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 813-17 (1976) . . . [and] claim that proceedings in over nine cases in state courts constitute compelling circumstances. There is nothing remarkable about parallel state litigation. Although it is not entirely clear how extraordinary the circumstances must be in order for the court to decline to exercise its jurisdiction in this context, it is clear that parallel proceedings alone is not sufficient.

R. App. 45. (citations omitted)

After receiving additional briefs, the District Court on November 10, 1994, granted DAI's 16 petitions to compel arbitration. *See Doctor's Associates, Inc. v. Emily Distajo, et al.*, 870 F. Supp. 34 (D.Conn. 1994). The court rejected petitioners' claim that DAI waived its right to arbitrate and held that the arbitration clause was mutually binding and not unconscionable. The court also held that the prior state court rulings did not preclude the federal court from granting DAI's petitions. *Id.* at 36.[9] On December 9, 1994, the District Court issued a separate decision in which the court expressly rejected the claim of the Illinois petitioners' that because the Madison County Circuit court had decided that the arbitration clause was unenforceable, the full faith and credit statute, 28 U.S.C. § 1738, prevented the District Court from granting DAI's petitions. The District Court concluded that Illinois courts would not give preclusive effect to the state court's ruling because DAI still had the right to appeal that ruling if its request

[9] The District Court apparently did not know about the October 24, 1994 ruling in Illinois until after it granted DAI's petitions to compel arbitration. For that reason, the District Court specifically addressed the preclusive effect of the Illinois ruling in its December 9, 1994 decision.

for reconsideration was denied. R. App. 51-52. The ruling therefore, was not "final" for *res judicata*/collateral estoppel purposes under Illinois law. *Id.* Each petitioner then took an appeal to the Second Circuit.

3. On December 16, 1994, less than a month after the District Court had compelled arbitration in the 16 *Distajo* actions, petitioners' counsel filed yet another lawsuit on behalf of two more Chicago-area franchisees -- Sandra and Raymond Bickel -- in Madison County state court. Once again, DAI promptly filed in the District Court a petition to compel arbitration pursuant to Section 4 of the FAA. On the day that he received notice of the Order to Show Cause hearing scheduled by the District Court, and acting without any notice to DAI, petitioners' counsel moved the Madison County Circuit Court for an order of default against DAI. The court entered a default judgment that same day, again without notice to DAI. Among other things, the Madison County Circuit Court purported to hold, through the default, that the arbitration clause in the Subway franchise agreement was not enforceable. *Distajo*, 66 F.3d at 449. DAI timely filed a motion to reopen the default, and when that motion was summarily denied, DAI appealed the default to the Illinois appellate court.[10/]

On February 13, 1995, the District Court granted DAI's petition to compel the Bickels to arbitrate in accordance with their arbitration agreement. The Bickels appealed the District Court's ruling, and their appeal was consolidated for oral argument with the already pending appeal of the *Distajo* franchisees.

4. On September 12, 1995 the Second Circuit issued its decision in the *Distajo* and *Bickel* appeals, a unanimous 41-page opinion authored by Judge José A. Cabranes. That

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[10] DAI's appeal is still pending; it has been stayed by the Illinois Appellate Court.

decision carefully considered and rejected most of petitioners' claims.[11/]

The first issue addressed by the Second Circuit was whether the District Court had subject matter jurisdiction over the Section 4 petitions. Petitioners argued that the existence of diversity jurisdiction in a Section 4 action is determined not by the citizenship of the parties before the federal court, but rather by the citizenship of the parties in any related state court case. Petitioners contended that their decision to sue some of DAI's local agents in their respective state court actions destroyed diversity in the federal actions, even though these individuals were not parties to the arbitration agreements and were not parties to DAI's Section 4 petitions.

The Second Circuit rejected petitioners' unprecedented interpretation of Section 4 and the requirements for diversity jurisdiction. *Distajo*, 66 F.3d at 445-46. As the Court explained, "[in] any federal action, diversity of citizenship is determined by reference to the parties named in the proceeding before the district court, as well as any indispensable parties who must be joined pursuant to Rule 19 of the Federal Rules of Civil Procedure." *Id.* at 445. DAI's local agents were not "indispensable parties" to the Section 4 action, in the Second Circuit's view, because the "district court can grant all the relief sought by DAI in this case -- an order compelling arbitration -- regardless of whether DAI's development agents (nonparties to the arbitration agreement) are present." *Id.* at 446. The Second Circuit also pointed out that petitioners' construction of Section 4 was flatly inconsistent with this Court's holding in *Moses H. Cone* that the FAA requires courts to enforce an arbitration agreement "notwithstanding the presence of other persons who are parties to the underlying dispute but

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[11] The Court reversed the District Court's failure to give full faith and credit to an Alabama judgment (see n. 8, *supra*) and remanded the case for additional consideration of two issues: (1) whether the arbitration clause was a product of fraud; and (2) whether DAI waived its right to arbitrate the dispute of any defendant. None of these issues is presented by the petition.

not to the arbitration agreement." *Id.*, citing, *Moses H. Cone*, 460 U.S. at 20. Because the parties did not dispute that there was complete diversity between DAI and each defendant in the Section 4 actions, the Second Circuit held that the District Court unquestionably had subject matter jurisdiction over the petitions. *Id.*

The Court next addressed whether the District Court should have given full faith and credit to the state court decisions. In deciding this issue, the Court recognized that "a federal court must 'give preclusive effect to state-court judgments whenever the courts of the State from which the judgments emerged would do so.' " *Id.* at 446, citing, *Allen v. McCurry*, 449 U.S. 90 (1980); *Valley Waste Disposal, Inc. v. Central Vermont Solid Waste Management Dist.*, 31 F.3d 89, 98 (2d Cir. 1994). Therefore, as the parties had agreed and the court acknowledged, the controlling question in each case was whether "the various state court judgments (. . . eight in Illinois and one in North Carolina) would be accorded preclusive effect under Illinois, or North Carolina law, respectively." *Distajo*, 66 F.3d at 446-47.

With respect to the decisions of the Illinois trial court, the Second Circuit observed that two directly controlling decisions of the Illinois Supreme Court hold that an Illinois trial court judgment is not final, and thus not entitled to preclusive effect, until all appellate rights have been exhausted. *Id.* at 449, citing *Ballweg v. City of Springfield*, 114 Ill. 2d 107, 113, 102 Ill. Dec. 360, 499 N.E.2d 1373 (Ill. 1986) and *Relph v. Board of Educ. of DePue Unit Sch. Dist.*, 84 Ill. 2d 436, 442, 50 Ill. Dec. 830, 420 N.E.2d 147 (Ill. 1981). After reviewing each decision, the Second Circuit concluded that "[d]espite the best efforts of the franchisees to distinguish *Ballweg* and *Relph*, we must follow the rulings of the Illinois Supreme Court." *Distajo*, 66 F.3d at 450. Because the Illinois state trial court rulings were, without doubt, still subject to appeal, the Second Circuit held that the District Court properly concluded that it was not required to give preclusive effect to these decisions. *Id.* at 449-50.

The Second Circuit also rejected petitioner Johnson's claims regarding the scope of the North Carolina state court ruling. "In North Carolina . . . collateral estoppel only precludes the relitigation of issues that were actually and necessarily decided in the earlier action." *Id.* at 450, citing *King v. Grindstaff*, 284 N.C. 348, 200 S.E.2d 799, 805 (1973). The Second Circuit observed that the written orders of the North Carolina court "did not explain why it denied the stay [under Section 3 of the FAA]", *Distajo*, 66 F.3d at 450, nor did they "make any findings of fact or conclusions of law regarding the arbitration clause." *Id.* Because petitioner could not satisfy his burden under North Carolina law of demonstrating "what was in fact determined by the[se] prior judgment[s]", the Second Circuit held that these rulings did not bar the District Court from compelling Mr. Johnson to arbitrate in accordance with his agreement with DAI. *Id.* at 450-51.

The Second Circuit also affirmed the District Court's ruling on abstention. The court did not expressly explain why the District Court had not committed an abuse of discretion in exercising jurisdiction over the petitions. However, by remanding the actions for further consideration, the Second Circuit implicitly recognized that the District Court's exercise of jurisdiction over DAI's petitions had been proper.

In September 1995, while petitioners' petitions for rehearing were pending in the Second Circuit, the Illinois petitioners filed a "Motion for Supervisory Order" with the Illinois Supreme Court. R. App. 66-89. That motion attempted to challenge the Second Circuit's conclusion that under Illinois law the Madison County Circuit Court's rulings were not entitled to preclusive effect. In essence, petitioners asked the Illinois Supreme Court to re-write the Illinois law on *res judicata*/collateral estoppel that the Second Circuit had properly applied. *Id.* The Illinois Supreme Court summarily denied petitioners' motion on October 31, 1995. R. App. 93. On November 22, 1995, the Second Circuit denied their petitions for rehearing. R. App. 61.

REASONS FOR DENYING THE PETITION

The Court should deny the Petition for Writ of Certiorari on each issue. The Second Circuit's decision that a federal court has subject matter jurisdiction over a Section 4 petition where there is complete diversity between the parties to the petition and no indispensable parties who would defeat diversity, is unremarkable and unquestionably correct. Even petitioners do not claim that the court's ruling conflicts with any decision of this Court or of any lower court. Petitioners' unprecedented reading of Section 4 is not supported either by the text of the FAA or by any of the traditional principles for determining diversity jurisdiction under Section 1332. Petitioners' argument also is illogical, since it would effectively eviscerate the federal courts' ability to enforce the FAA through petitions to compel arbitration under Section 4.

Petitioners fare no better in seeking review of the Second Circuit's decision on the preclusive effect of the Illinois and North Carolina state court rulings. Petitioners concede that the Second Circuit correctly held that under the full faith and credit statute, a district court is required to give state court decisions as much preclusive effect as, but no more than, each decision would receive in the forum state. Whether the Second Circuit correctly applied the law of Illinois and North Carolina on preclusion to the particular facts of each case does not present an issue that warrants this Court's review. Moreover, it is clear that the Second Circuit properly applied Illinois and North Carolina law to the facts of this case.

Finally, there is no reason for this Court to review the fact-specific determination of whether the District Court abused its discretion in exercising jurisdiction over DAI's Section 4 petitions. Petitioners' claim that the court's exercise of jurisdiction conflicts with this Court's ruling in *Moses H. Cone*, 460 U.S. 1 (1983), is fanciful. In fact, petitioners' argument turns the actual holding of *Moses H. Cone* on its head, since that decision held that a district court had *abused* its discretion in declining to exercise jurisdiction over a Section 4 petition despite the pendency of parallel state court litigation. The

District Court's exercise of jurisdiction here served the important goal of allowing the parties to have their rights under the FAA to enforce agreements to arbitrate determined in a consistent manner in the forum provided by Congress in the FAA.

I. THERE IS NO NEED TO "CLARIFY" THAT A FEDERAL COURT HAS SUBJECT MATTER JURISDICTION OVER A SECTION 4 PETITION WHERE THERE IS COMPLETE DIVERSITY BETWEEN THE PARTIES.

Petitioners concede, as they must, that the Second Circuit correctly ruled that Section 4 of the FAA confers jurisdiction on the District Court to hear petitions to enforce arbitration agreements "but only to the extent that the Court would otherwise have [subject matter] jurisdiction over the dispute." *Distajo*, 66 F.3d at 444. They also do not dispute that there is complete diversity between the parties to DAI's Section 4 petitions and do not appear to contest the Second Circuit's ruling that the other parties to the state court actions -- who are not parties to the arbitration agreements -- were not "indispensable" parties under Rule 19 of the *Federal Rules of Civil Procedure*. *See* Petitioners' Brief at 13-14. Petitioners are left to argue, therefore, that under Section 4 it is the citizenship of the parties to related state court actions, and not the citizenship of the parties to the federal action, that is determinative of subject matter jurisdiction over a petition to compel arbitration.

As the Second Circuit concluded, petitioners' argument is contrary to the language of Section 4 and is without precedent. *Distajo*, 66 F.3d at 445. Section 4 of the FAA provides, in part:

> A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order

> directing that such arbitration proceed in the manner provided for in such agreement . . ..

9 U.S.C. § 4. As the Second Circuit recognized, the "controversy between the parties" in Section 4 refers to the dispute between the "party aggrieved by the alleged failure . . . of another to arbitrate", and the party contesting arbitration about whether the arbitration should "proceed in the manner provided for in such agreement." *Distajo*, 66 F.3d at 445-46. Section 4 also expressly states that the court must have "jurisdiction under Title 28," thereby incorporating the usual rules for determining diversity jurisdiction under Section 1332. Petitioners have never identified any language in the text of the FAA or its legislative history that even remotely suggests that Congress intended that diversity of citizenship would be determined by the citizenship of parties to a separate state court action, where the person seeking to avoid his agreement to arbitrate has, in furtherance of that goal, sued additional defendants.

Moreover, petitioners' assertion is also fundamentally at odds with this Court's decision in *Moses H. Cone*, *supra*. There, this Court held that "under the [FAA], an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." *Moses H. Cone*, 460 U.S. at 20. If petitioners were correct, *Moses H. Cone* would never have been decided since, as here, that case arose out of parallel state court litigation involving non-diverse parties. *Moses H. Cone*, 460 U.S. at 7, n. 4. The Second Circuit's ruling on subject matter jurisdiction also is consistent with two recent decisions by the United States Court of Appeals for the Fifth Circuit, each of which hold that a district court must look only to the parties named in a Section 4 petition when determining whether diversity jurisdiction exists. *Snap-On Tools Corporation v. Mason*, 18 F.3d 1261, 1266-67 (5th Cir. 1994); *Prudential-Bache Sec., Inc. v. Fitch*, 966 F.2d 981, 988 (5th Cir. 1992).

Finally, the flaws in petitioners' position are also underscored by the practical effect that their interpretation of Section 4 would have on the ability of parties to compel arbitration under the FAA. If petitioners were correct, a corporation doing business nationwide rarely would be able to bring an action in federal court to compel arbitration with a non-diverse party. If a federal court were required to determine diversity according to the parties sued in a state court case, the district court, as a practical matter, could never exercise jurisdiction over a Section 4 petition, since a person resisting arbitration can almost always find some resident employee or other alleged agent of the corporation to sue in state court. As the Second Circuit recognized, therefore, the petitioners' interpretation would eviscerate the rights granted by Section 4, because the statute, on its face, provides that petitions to compel can only be brought in federal court, and only in the district where the arbitration would occur. *Distajo*, 66 F.3d 445-46. *See also Snyder v. Smith*, 736 F.2d 409, 420 (7th Cir.), *cert. denied*, 469 U.S. 1037 (1984); *Aaacon Auto Transport Inc. v. Ninfo*, 490 F.2d 83, 84 (2d Cir. 1974); *National Iranian Oil Co. v. Ashland Oil, Inc.*, 641 F. Supp. 211, 213 (S.D. Miss. 1986), *aff'd.* 817 F.2d 326 (5th Cir. 1987), *cert. denied*, 484 U.S. 943 (1987).

II. THERE IS NO REASON FOR THE COURT TO REVIEW THE SECOND CIRCUIT'S APPLICATION OF ILLINOIS AND NORTH CAROLINA LAW TO THE FACTS OF THIS CASE.

Petitioners do not contend that the Second Circuit was incorrect in holding that under the full faith and credit statute, 28 U.S.C. § 1738, a federal court must give a state court decision as much preclusive effect as, but no more than, the decision would receive in the forum state. *Migra v. Warren City Sch. Dist. Bd. of Educ.*, 465 U.S. 75, 81 (1984); *Kremer v. Chemical Constr. Corp.*, 456 U.S. 461, 466 (1982); *Marresse v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 380 (1985); Wright, Miller & Cooper, *Federal Practice and Procedure* § 4469 (1981 & Supp. 1994). Thus, even

petitioners concede that the Second Circuit correctly applied the relevant federal legal standard and correctly articulated the relevant issue of state law -- namely, what preclusive effect would Illinois and North Carolina give to the state court decisions in this case. Petitioners merely argue that the Second Circuit misapplied the law of Illinois and North Carolina in deciding that the trial court rulings from those states did not preclude the District Court from determining DAI's Section 4 petitions. For the reasons discussed below, there is no reason for this Court to review the Second Circuit's application of these states' laws to the particular facts of these cases.

A. Petitioners claim that this Court must resolve a supposed split between the Second Circuit and the Illinois Supreme Court about whether the Madison County Circuit Court's rulings barred the District Court from deciding DAI's petitions. However, this supposed "conflict" exists only in petitioners' imagination. As the Second Circuit recognized, it is well settled under Illinois law that a trial court ruling has no *res judicata* or collateral estoppel effect unless and until it is a final judgment. *Sampson v. Cape Industries Ltd.*, 593 N.E.2d 1158, 1161 (Ill. App. 1992); *People v. Shlensky*, 454 N.E.2d 1103, 1106 (Ill. App. 1993). And under Illinois law, judgments are considered final for *res judicata*/collateral estoppel purposes **only** after all appeals have been exhausted, and **only** when all that is left in the case is execution on the judgment. *Ballweg*, 499 N.E.2d 1373 (Ill. 1986); *Relph*, 420 N.E.2d 147 (Ill. 1981); *Pelon v. Wall*, 634 N.E.2d 385 (Ill. App. 1994). There simply can be no question that this is the law of Illinois. Indeed, federal courts applying Illinois law have uniformly recognized these principles. *See e.g.*, *In re Leigh*, 165 B.R. 203, 217 (N.D. Ill. 1993) (in Illinois, "finality requires that the potential for appellate review has been exhausted"); *In re Richey*, 104 B.R. 5 (S.D. Ill. 1989) (same). Accordingly, the Second Circuit was unquestionably correct in holding that under the Illinois Supreme Court's decisions in *Ballweg* and *Relph*, the District Court properly declined to accord preclusive effect to the Madison County Circuit Court rulings.

Petitioners' reliance on purportedly contrary authority from Illinois intermediate courts obviously does not create a "conflict" between the Second Circuit and the Illinois Supreme Court. *See* Petition at 17-18. Petitioners' assertion of a "split" is also undermined by their failed attempt to convince the Illinois Supreme Court to review this very issue. As discussed previously, in their Motion for Supervisory Order with the Illinois Supreme Court, petitioners asked the Illinois Supreme Court effectively to overrule *Ballweg* and *Relph* and hold that the Madison County orders should be given preclusive effect. R. App. 66-89. That the Illinois Supreme Court summarily declined petitioners' invitation lends a hollow ring to their claim that this Court should expend its resources to resolve a question of Illinois law that is well settled.

B. Petitioner Johnson does not even argue that the Second Circuit applied the wrong legal standard under North Carolina law in reviewing his collateral estoppel claim. Indeed, the parties expressly agreed below that a ruling by the North Carolina court that actually decided DAI's rights under the FAA would be treated as "final" for purposes of *res judicata* and collateral estoppel by North Carolina courts. The parties also agreed that *res judicata* and collateral estoppel apply only to matters actually litigated and decided in the earlier action. *King*, 200 S.E.2d at 805 (N.C. 1973); *York v. Northern Hosp. Dist.*, 96 N.C. App. 456, 459, 386 S.E.2d 99, 101 (N.C. App. 1989); *Mason v. Highway Comm.*, 7 N.C. App. 644, 647, 173 S.E.2d 515, 516 (N.C.App. 1970).

Thus, the issue that the Second Circuit decided was the fact-specific question of whether the particular orders rendered by the North Carolina trial court actually decided DAI's rights under the FAA. In resolving that issue, the Second Circuit recognized that in North Carolina, the party invoking *res judicata* or collateral estoppel bears the burden of establishing what was actually determined by the prior judgment. *Distajo*, 66 F.3d at 450, citing, *Thomas M. McInnis & Assocs., Inc. v. Hall*, 318 N.C. 421, 429, 349 S.E.2d 552, 557 (N.C. 1986). *See also, Hales v. North Carolina Ins. Guar. Ass'n*, 111 N.C.

App. 892, 895, 433 S.E.2d 468, 470 (N.C. App. 1993).[12/] Here, the North Carolina court's rulings explicitly addressed only the issue of whether Mr. Johnson's prior participation in arbitration with DAI waived his right to challenge enforcement of the arbitration clause. The state court made no findings of fact or conclusions of law regarding any of petitioner's objections to proceeding with arbitration and did not consider the enforceability of the arbitration agreement. Accordingly, the Second Circuit was correct in concluding that the decision of the North Carolina court "would not be accorded preclusive effect under North Carolina law with respect to the validity of the arbitration clause." *Distajo*, 66 F.3d at 451.

At bottom, petitioner merely disagrees with the Second Circuit's conclusion that the orders of the North Carolina court did not decide whether petitioner was required to arbitrate with DAI. There is no reason for this Court to grant certiorari to review such a narrow, fact-specific determination that has no application beyond the parties to this case. *See, e.g., NCAA v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 98 n.15 (1984); *Rogers v. Lodge*, 458 U.S. 613, 623 (1982); *Graver Mfg. Co. v. Linde Co.*, 336 U.S. 271, 275 (1949); *U.S. v. Doe*, 465 U.S. 605 (1984).

---

[12] Federal courts have recognized that in an action under Section 4, collateral estoppel will only prevent "relitigation of arbitrability once it has been actually litigated and is essential to the first decision." *Midwest Mechanical Contractors, Inc. v. Commonwealth Constr. Co.*, 801 F.2d 748, 750-51 (5th Cir. 1986). "[I]f there is no showing as to the issues that were *actually* decided, there is no issue preclusion." *Id.* (*citing* Wright, Miller & Cooper, *Federal Practice and Procedure*, § 4420 (1981 & Supp. 1994) (emphasis added). Thus, where an order denying either a stay or a petition to compel under the FAA fails to state its basis, neither *res judicata* nor collateral estoppel bars the litigation of arbitrability. *Midwest Mechanical Contractors*, 801 F.2d at 751-52.

III. THERE IS NO REASON TO REVIEW THE DISTRICT COURT'S DECISION NOT TO ABSTAIN UNDER THE PARTICULAR FACTS OF THIS CASE.

This petition arises out of an unique procedural history and involves a highly unusual set of facts. Since there is no dispute or conflict as to the relevant legal principles at issue, and since it is clear that petitioners' abstention claim turns largely on the uncommon facts of these cases, there is no reason for the Court to grant petitioners' request to review the District Court's exercise of jurisdiction over DAI's Section 4 petitions.

Petitioners contend that the District Court's refusal to abstain somehow conflicts with this Court's decision in *Moses H. Cone*. Yet in making this argument, petitioners ignore the holding of *Moses H. Cone*. There, this Court held that the existence of parallel state court litigation -- the only factor relied upon by petitioners here -- is not an "exceptional circumstance" that permits a district court to abstain from exercising jurisdiction over a Section 4 petition to compel arbitration. *Moses H. Cone*, 460 U.S. at 21-26. Thus, this Court held that the district court's "refusal to proceed was plainly erroneous in view of Congress' clear intent, in the Arbitration Act, to move parties to an arbitrable dispute out of court and into arbitration as quickly and easily as possible." *Id.* at 24. As the Court explained:

> The basic issue presented in [the] federal suit was the arbitrability of the dispute between Mercury and the Hospital. Federal law in the terms of the Arbitration Act governs that issue in either state or federal court. . . . [O]ur task in cases such as this is not to find some substantial reason for the *exercise* of federal jurisdiction by the district court; rather, the task is to ascertain whether there exist "exceptional" circumstances, the "clearest of justifications," that can suffice under *Colorado River* to justify the *surrender* of that jurisdiction. Although in some rare circumstances

> the presence of state-law issues may weigh in favor of that surrender . . . the presence of federal-law issues must always be a major consideration weighing against surrender.

Id. at 24-26 (emphasis in original).

The only distinction between this case and *Moses H. Cone* is that petitioners' dilatory motion practice here slowed resolution of the petitions and deprived DAI of its right to "rapid and unobstructed enforcement of arbitration agreements." *Moses H. Cone*, 460 U.S. at 23. That this tactic, which runs counter to Congress's intent in enacting the FAA, resulted in the entry of summary rulings in Illinois and North Carolina state courts that the Second Circuit properly held have no preclusive effect, in no way constitutes the "exceptional-circumstances" required for abstention that were described in *Colorado River*, 424 U.S. 800 (1976). In view of the holding in *Moses H. Cone*, it is not surprising that petitioners are unable to point to a single decision, either by this Court or any lower federal court, that conflicts with the decision of the District Court to exercise jurisdiction in this case.

Finally, petitioners' claim that the District Court's exercise of jurisdiction over these petitions resulted in "piecemeal" litigation is equally baseless. Quite the contrary, when the District Court exercised jurisdiction over the petitions, it sought to avoid the possibility of inconsistent rulings on arbitrability in various state courts and to resolve the parties' rights under federal law in a consistent, uniform manner in the forum specified by Congress in the FAA. The District Court, therefore, fully complied with its "unflagging obligation" to exercise jurisdiction over a Section 4 petition, even where there is parallel state court litigation. *Moses H. Cone*, 460 U.S. at 15 (citations omitted).

CONCLUSION

For the reasons set forth above, the Petition for Writ of Certiorari should be denied.

Respectfully submitted,

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Dated March 1, 1996.

(4)

No. 95-1086

Supreme Court, U.S.
FILED
MAR 1 1996
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1995

EMILY DISTAJO, et al.,

Petitioners,

vs.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

ON PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

APPENDIX TO BRIEF IN OPPOSITION TO PETITION FOR WRIT OF CERTIORARI

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APPENDIX A

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1724, 1725, 1726, 1988 August Term, 1994

(Argued: June 7, 1995 Decided: Sep 12, 1995)

Docket Nos. 94-9207, 94-9293, 94-9209, 95-7183

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

v.

EMILY DISTAJO, RENATO DISTAJO, CONSTANTINO LAMANDO, MILO LAMANDO, JOSE ALBERTO BRENES, ALVARO GUERRERO, MARIA T. GUERRERO, WESAM S. YOUMARAN, LINDA YOUMARAN, JULIE SHINO, JOHNSON SHINO, ALBERT YONAN, LEYLAH YONAN, LOUIS LOENNEKE, MARY ANN BOOKOUT, MICHAEL JOHNSON, DEBORAH A. KANE, GREGORY F. KANE, BRUNO GIANINNI, RONALD ROTHMUND, PATRICIA ROTHMUND, JOHN S. PAPALEO, JOHN A. McCRARY, JOHN GILLON, SONYA SMITH, PAUL RIISE, MELISSA RIISE, and RHONDA BENTON,

Defendants-Appellants.

and

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

v.

RAYMOND BICKEL and SANDRA BICKEL,

Defendants-Appellants.

Before: MINER, LEVAL and CABRANES, *Circuit Judges.*

Appeal from several orders of the United States District Court for the District of Connecticut (Peter C. Dorsey, *Chief Judge*), denying certain appellants' motions to dismiss, granting appellee's petitions to compel arbitration, and entering a preliminary injunction barring appellants from pursuing parallel state litigation. Appellants contend that (1) the district court lacked subject matter jurisdiction; (2) the district court should have accorded preclusive effect to judgments entered in state courts against DAI; (3) the arbitration clause is void for "lack of mutuality"; (4) DAI waived its right to compel arbitration by initiating litigation through a shell corporation; and (5) the district court should have decided whether the appellants were fraudulently induced to enter the arbitration agreement, rather than leaving that question for the arbitrators.

Reversed in part and affirmed in part.

DAVID M. DUREE, Reinert, Duree & Crane, St. Louis, Missouri, *for Defendants-Appellants Emily Distajo, Renato Distajo, Constantino Lamando, Milo Lamando, Jose Brenes, Alvaro Guerrero, Maria Guerrero, Wesam Youmaran, Linda Youmaran, Julie Shino, Johnson Shino, Albert Yonan, Leylah Yonan, Louis Loenneke, Mary Ann Bookout, Michael Johnson, Deborah A. Kane, Gregory F. Kane, Bruno Gianinni, Ronald Rothmund, Patricia Rothmund, John S. Papaleo, Raymond Bickel and Sandra Bickel.*

Edward E. Angwin, Birmingham, Alabama, *for Defendants-Appellants John A. McCrary, John Gillon, Sonya Smith, Paul Riise, Melissa Riise, and Rhonda Benton.*

Nicholas Wocl, Tooher, Puzzuoli & Wocl, Stamford, Connecticut, *for all Defendants-Appellants.*

Edward Wood Dunham, Wiggin & Dana, New Haven, Connecticut, *for Plaintiff-Appellee.*

JOSÉ A. CABRANES, *Circuit Judge:*

This case is about forum-shopping, by one and all. Doctor's Associates, Inc. ("DAI") is the national franchisor of Subway sandwich shops. DAI and its franchisees entered into standard franchise agreements, which required them to arbitrate all contractual disputes in Bridgeport, Connecticut, under Connecticut law. When problems did arise, however, neither side invoked the arbitration clause. First, DAI directed its wholly owned real-estate leasing companies to bring summary eviction proceedings against the franchisees in local state courts.[1] The franchisees, in turn, scrambled to obtain judgments against DAI in local state courts.

When DAI found itself faced with state court claims around the country, it sought shelter in the arbitration clause of its franchise agreements. Accordingly, it petitioned the federal district court in Connecticut to compel arbitration under the Federal Arbitration Act. Before the district court could act, some of the franchisees won state court judgments against DAI. But DAI eventually convinced the district court to enjoin the franchisees from pursuing their state actions--even from enforcing judgments already entered--and to send the parties to Bridgeport to resolve their disputes around the arbitral table.

On appeal, we are presented with several questions relating to the Federal Arbitration Act: (1) whether a district court has

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[1] DAI and other franchisees have been involved in similar litigation around the country. *See, e.g., Kroll v. Doctor's Assocs., Inc.*, 3 F.3d 1167 (7th Cir. 1993); *Mosca v. Doctors Assocs., Inc.*, 852 F. Supp. 152 (E.D.N.Y. 1993); *Wilson v. Subway Sandwiches Shops, Inc.*, 823 F. Supp. 194 (S.D.N.Y. 1993); *In re Sims*, 1991 U.S. Dist. LEXIS 13664 (E.D. La. 1991); *Yates v. Doctor's Assocs., Inc.*, 193 Ill. App. 3d 431, 549 N.E.2d 1010 (5th Dist. 1990); *Cox v. Doctor's Assocs., Inc.*, 245 Ill. App. 3d 186, 613 N.E.2d 1306 (5th Dist.), *appeal denied*, 152 Ill.2d 556 (1993), *cert. denied*, 114 S. Ct. 1069 (1994); *Casarotto v. Lombardi*, 268 Mont. 369, 886 P.2d 931 (1994), *vacated and remanded*, 115 S. Ct. 2552 (1995).

The relationship between DAI and the Bickels' landlord has also been the subject of litigation. *Jannotta v. Subway Sandwich Shops, Inc.*, 1995 U.S. Dist. LEXIS 7586 (N.D. Ill. 1995).

subject matter jurisdiction over a petition to compel arbitration where there is complete diversity among all the parties to the arbitration agreement (all of whom are joined as parties in the petition), but where other, nondiverse parties have been joined as defendants in a parallel state action involving the same underlying dispute; (2) whether the district court should have accorded preclusive effect to various state court judgments entered in Alabama, Illinois, and North Carolina courts; (3) whether an arbitration clause is void for "lack of mutuality" under Connecticut law if it requires only one party to submit disputes to arbitration; (4) whether a party to an arbitration agreement waives its right to compel arbitration when it litigates substantial issues through an alter ego; and (5) whether a district court or an arbitrator should decide whether a party was fraudulently induced to assent to an arbitration agreement.

The district court found complete diversity, refused to accord preclusive effect to the state court judgments, found that the arbitration clause did not lack mutuality, held that DAI had not waived its right to arbitrate regardless of whether its leasing affiliates, which brought the court proceedings, were its alter egos, and left the question of fraudulent inducement to the arbitrators. As discussed below, we affirm in part and reverse in part.

I. FACTS

Doctor's Associates, Inc. ("DAI"), a Florida corporation, is the national franchisor of "Subway" sandwich shops. DAI entered into identical franchise agreements with each of the defendant franchisees (the "Franchisees").[2] Each agreement

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[2] For convenience, we shall refer to the franchisees individually according to the following case numbers, or collectively according to the state in which they brought suit, e.g., the "Alabama franchisees." We list the district court docket number, as well as the state of each group of franchisees whose cases were consolidated under the heading of *Doctor's Associates, Inc. v. Distajo*:

Case #1: 3:94-CV-349 *Doctor's Associates, Inc. v. Distajo* (IL)

(Footnote continued)

contains an identical arbitration clause, which provides that any claim arising out of or relating to the franchise agreement must be arbitrated in Bridgeport, Connecticut, under the Commercial Arbitration Rules of the American Arbitration Association. According to the arbitration clause, no party may take legal action against the other in connection with the franchise agreement without first attempting to arbitrate the dispute.[3]

Case #2: 3:94-CV-511	*Doctor's Associates, Inc. v. Brenes* (IL)
Case #3: 3:94-CV-514	*Doctor's Associates, Inc. v. Guerrero* (IL)
Case #4: 3:94-CV-515	*Doctor's Associates, Inc. v. Youmaran* (IL)
Case #5: 3:94-CV-516	*Doctor's Associates, Inc. v. Shino* (IL)
Case #6: 3:94-CV-517	*Doctor's Associates, Inc. v. Loenneke* (IL)
Case #7: 3:94-CV-803	*Doctor's Associates, Inc. v. Johnson* (NC)
Case #8: 3:94-CV-354	*Doctor's Associates, Inc. v. McCrary* (AL)
Case #9: 3:94-CV-369	*Doctor's Associates, Inc. v. Gillon* (AL)
Case #10: 3:94-CV-370	*Doctor's Associates, Inc. v. Smith* (AL)
Case #11: 3:94-CV-371	*Doctor's Associates, Inc. v. Risse* (AL)
Case #12: 3:94-CV-372	*Doctor's Associates, Inc. v. Benton* (AL)
Case #13: 3:94-CV-948	*Doctor's Associates, Inc. v. Kane* (MA)
Case #14: 3:94-CV-1108	*Doctor's Associates, Inc. v. Giannini* (PA)
Case #15: 3:94-CV-1456	*Doctor's Associates, Inc. v. Rothmund* (IL)
Case #16: 3:94-CV-1457	*Doctor's Associates, Inc. v. Papaleo* (IL)

Although *DAI v. Bickel* was not consolidated with the other sixteen cases before the district court, it was consolidated for purposes of oral argument before this court.

[3] The arbitration clause provides as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in

(Footnote continued)

DAI requires each franchisee to sublease its premises from one of several real-estate leasing companies that are wholly owned by DAI. Each sublease contains a "cross-default" provision, whereby any breach of the franchise agreement by the franchisee constitutes a breach of the sublease.[4] According to the deposition testimony of one of its own officers, DAI wanted its leasing affiliate to be the franchisees' sublessor to obtain greater leverage over them in the event of a dispute.

A. *The District Court Proceedings in Doctor's Associates, Inc. v. Distajo (Nos. 94-9207, 94-9209, 94-9293)*

From 1991 through 1993, various disputes arose between DAI and the several franchisees. DAI never filed any demands for arbitration, despite its claims that the franchisees had breached the franchise agreements. Instead, DAI directed its leasing companies to invoke the cross-default provisions of the subleases, and to institute eviction proceedings in state courts against each franchisee.

In response to these eviction proceedings, each of the franchisees filed a state court action claiming, *inter alia*, fraud and breach of contract by DAI, its leasing companies, and several of DAI's officers and agents.

> Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

[4] The cross-default provision reads in relevant part as follows:

> If at any time during the term of this Sublease, Sublessee shall default in the performance of any of the terms, covenants or conditions of the aforesaid Franchise Agreement . . . Sublessor, at its option, may terminate this lease . . . and upon such termination, Sublessee shall quit and surrender the leased premises to Sublessor . . . .

According to the franchisees, DAI uses this subleasing arrangement to circumvent the arbitration clause in the franchise agreements. They argue that the leasing companies are mere shells, or alter egos, of DAI. It is undisputed that the leasing companies are wholly owned by DAI, that they have no assets or net income, and that DAI decides when the leasing companies will file eviction proceedings. Pursuant to the sublease, the franchisee must pay rent directly to the actual landlord; no rent is paid to the leasing company. According to the franchisees, DAI has taken the position that the arbitration clause in the franchise agreement is not binding on its leasing companies, because they are not parties to that agreement. The franchisees claim also that the leasing companies have asserted the right to proceed with eviction lawsuits against the franchisees even if the franchisees file arbitration demands against DAI. Thus, DAI allegedly brought eviction lawsuits through its leasing companies to pressure its franchisees into resolving disputes, but invokes the arbitration clause to protect itself against litigation initiated by the franchisees.

DAI responded to each state lawsuit brought by the franchisees by serving a demand for arbitration pursuant to the franchise agreement. When the franchisees refused to arbitrate their disputes, DAI filed petitions to compel arbitration, pursuant to the Federal Arbitration Act, 9 U.S.C. § 4, in the United States District Court for the District of Connecticut. All sixteen cases were eventually consolidated before Chief Judge Peter C. Dorsey. Before the district court ruled on DAI's petitions, the state courts in Alabama, Illinois, and North Carolina entered judgments in favor of the franchisees in Cases 1-12 and 15-16.

In the district court, DAI contended that the franchisees were bound by the franchise agreement to submit any disputes with DAI to arbitration in Bridgeport, Connecticut, before instituting judicial proceedings. The franchisees responded by seeking dismissal of DAI's petitions on several grounds, including, *inter alia*: (1) lack of subject matter jurisdiction, due to incomplete diversity of the parties; and (2) collateral estoppel, based on the intervening state court judgments. The

district court rejected each of these contentions in a ruling dated September 29, 1994. The district court simultaneously rejected DAI's motion to enjoin the franchisees from pursuing parallel state court proceedings, on the grounds that the requested injunction did not fall within any of the narrow exceptions to the Anti-Injunction Act, 28 U.S.C. § 2283.

On November 10, 1994, the district court granted DAI's petitions to compel arbitration. In doing so, the court rejected several defenses raised by the franchisees, including the following: (1) that the arbitration clause was void for lack of mutuality; (2) that DAI had waived arbitration by virtue of its leasing companies' prosecution of eviction lawsuits; and (3) that DAI had fraudulently misrepresented the scope of the arbitration clause in the franchise agreement. The court held that the arbitrators, not the court, should determine whether the leasing companies were "alter egos" of DAI, and then address the question whether DAI had fraudulently misrepresented the scope of the arbitration agreement.

When the franchisees continued to pursue their state court actions, DAI obtained a temporary restraining order from the district court on November 22, 1994, preventing them from participating in the parallel state proceedings. On December 14, 1994, the district court entered a preliminary injunction, barring the Distajo franchisees from seeking enforcement of their Illinois judgment. *Doctor's Assocs., Inc. v. Distajo*, 870 F. Supp. 34 (D. Conn. 1994). The court concluded that injunctive relief was "not inappropriate" under the Anti-Injunction Act, 28 U.S.C. § 2283, because continued state litigation would "impair the integrity of the order of arbitration." In granting DAI's motion, the court rejected the franchisees' argument that an intervening judgment entered in favor of the Distajo franchisees by an Illinois state court on October 24, 1994, was "final" for *res judicata* purposes and would preclude entry of the injunction under the full faith and credit statute, 28 U.S.C. § 1738.

All of the franchisees filed timely appeals from the district court's order of September 29, 1994, denying their motions to

dismiss, and the order of November 10, 1994, compelling arbitration. All of the franchisees except those from Alabama (Cases 8-12) also appeal from the court's December 9, 1994, order entering the preliminary injunction.

B. *The District Court Proceedings in Doctor's Associates, Inc. v. Bickel (No. 95-7183)*

The proceedings in the *Bickel* case differ somewhat from those cases consolidated under the *Distajo* rubric. On December 16, 1994, the Bickels filed a complaint in Illinois state court against DAI, its leasing company, its development agent, and three DAI officers. DAI responded by filing a petition to compel arbitration in the United States District Court for the District of Connecticut on January 20, 1995, and moved to enjoin the Bickels from prosecuting their state court action. On February 7, 1995, the Illinois court entered a default judgment against DAI. On February 13, 1995, Chief Judge Dorsey granted both DAI's petition to compel arbitration and its motion for a preliminary injunction, while permitting DAI to move the Illinois court to vacate the default judgment on the basis of defective service of process. The district court entered a written order embodying the *Bickel* injunction on May 9, 1995, but did not order DAI to post a bond.

The Bickels appeal from the court's order of May 9, 1995, granting DAI's petition to compel arbitration and entering the preliminary injunction.

I. DISCUSSION

"When reviewing a district court's determination of its subject matter jurisdiction, we review factual findings for clear error and legal conclusions de novo." *In re Vogel Van & Storage, Inc.*, 59 F.3d 9, 11 (2d Cir. 1995). We also review *de novo* the district court's decision to compel arbitration. *Collins & Aikman Prods. Co. v. Building Systems, Inc.*, 58 F.3d 16, 19 (2d Cir. 1995).

A. *Subject Matter Jurisdiction*

Section 4 of the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1-16, confers jurisdiction on district courts to hear petitions to enforce arbitration agreements, but only to the extent that the court would otherwise have jurisdiction over the dispute. The statute provides as follows:

> A party aggrieved by the alleged . . . refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action . . . of the subject matter of *a suit arising out of the controversy between the parties*, for an order directing that such arbitration proceed in the manner provided for in such agreement.

9 U.S.C. § 4 (emphasis added). As the Supreme Court has explained,

> [t]he Arbitration Act is something of an anomaly in the field of federal-court jurisdiction. It creates a body of federal substantive law establishing and regulating the duty to honor an agreement to arbitrate, yet it does not create any independent federal-question jurisdiction under 28 U.S.C. § 1331 (1976 ed., Supp. V) or otherwise. Section 4 provides for an order compelling arbitration only when the federal district court would have jurisdiction over a suit on the underlying dispute; hence, there must be diversity of citizenship or some other independent basis for federal jurisdiction before the order can issue.

Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp., 460 U.S. 1, 25 n.32 (1983).

The parties seem to agree that the only possible basis for federal subject matter jurisdiction in this case would be diversity of citizenship. 28 U.S.C. § 1332. It is a long-settled rule that in order to invoke diversity jurisdiction, the petitioner must show "complete diversity"--that is, that it does not

share citizenship with any defendant. *C.T. Carden v. Arkoma Assocs.*, 494 U.S. 185, 187 (1990); *Strawbridge v. Curtiss*, 7 U.S. (3 Cranch) 267, 267 (1806), *overruled on other grounds*, 43 U.S. (2 How.) 497, 555 (1844); *Curley v. Brignoli, Curley & Roberts Assocs.*, 915 F.2d 81, 84 (2d Cir. 1990), *cert. denied*, 499 U.S. 955 (1991). DAI is a Florida corporation with its principal place of business in Florida. The franchisees are residents of Alabama, Illinois, Massachusetts, North Carolina, and Pennsylvania.

The franchisees argue that there is not complete diversity of citizenship here. According to the franchisees, the "controvers[ies] between the parties" to which the FAA refers involve not only DAI, but also DAI's development agents--some of whom share the same citizenship with certain franchisees. None of those agents was a party to the franchise agreement; none has been joined as a party in the present proceeding. These local DAI agents, the franchisees contend, are "indispensable parties" to the present federal action, as evidenced by the fact that the affiliates are named defendants in the franchisees' state actions. In other words, the franchisees argue that their state court actions are the "suit[s] arising out of the controversy between the parties" hypothesized by the FAA. If so, then the citizenship of all the parties in the state actions determines whether there is complete diversity in the federal action to compel arbitration. Because these agents cannot be joined without destroying diversity, the franchisees argue that the district court should have dismissed the petitions to compel.

DAI responds that the "suit arising out of the controversy between the parties" is DAI's action to compel arbitration--not the parallel state action--and that DAI's affiliates are not "indispensable parties" to the federal action. Accordingly, DAI argues that we should look at the citizenship only of the parties named in the petition to compel, when determining whether there is diversity jurisdiction. *Prudential-Bache Sec., Inc. v. Fitch*, 966 F.2d 981, 988 (5th Cir. 1992) ("jurisdiction for a petition to compel arbitration [must] be determined from the face of the petition"). DAI offers a textual argument and a

policy argument to support its position. First, it notes that the FAA asks whether the district court would have jurisdiction over a suit arising out of a controversy "between the parties." The phrase "the parties" most sensibly refers to those persons who are parties to the arbitration agreement--and who therefore can be named in the petition to compel arbitration. Second, DAI argues that the FAA would be fatally undermined if "the parties" described in § 4 could be expanded to include persons who had not signed the arbitration clause but who allegedly were involved in the "underlying controversy." If such a rule were adopted, a party resisting arbitration could defeat federal jurisdiction simply by suing someone from the same state, plus the party seeking to compel arbitration, in a separate state lawsuit. Diversity would be destroyed simply by claiming that the local defendants in the parallel action were "indispensable parties" to the petition to compel.

We agree with DAI. The "parties" to which § 4 of the FAA refers are the parties to the petition to compel. As with any federal action, diversity of citizenship is determined by reference to the parties named in the proceeding before the district court, as well as any indispensable parties who must be joined pursuant to Rule 19 of the Federal Rules of Civil Procedure. Where joinder of a party would destroy subject matter jurisdiction, the court must dismiss the action if that party is "indispensable" to the litigation. Fed. R. Civ. P. 19(b),[5]

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[5] Rule 19(b) provides:

Determination by Court Whenever Joinder not Feasible. If a person as described in subdivision (a)(1)-(2) hereof cannot be made a party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it, or should be dismissed, the absent person being thus regarded as indispensable. The factors to be considered by the court include: first, to what extent a judgment rendered in the person's absence might be prejudicial to the person or those already parties; second, the extent to which, by protective provisions in the judgment, by the shaping of relief, or other measures, the prejudice can be lessened or avoided; third, whether a judgment rendered in the person's absence will be adequate; fourth, whether the plaintiff will have an adequate remedy if the action is dismissed for nonjoinder.

Fluent v. Salamanca Indian Lease Auth., 928 F.2d 542, 548 (2d Cir.) (finding dismissal proper where indispensable party was Indian tribe that enjoyed sovereign immunity from suit), *cert. denied*, 502 U.S. 818 (1991). But individuals who are not parties to the arbitration agreement cannot be "indispensable" parties under Rule 19(b) if they do not meet either of the threshold tests of Rule 19(a).[6] That provision only requires joinder of a party if (1) the court cannot afford "complete relief" to those already joined, in the absence of that party, and (2) the unjoined party has an interest in the litigation and his absence may either impede his ability to protect that interest or subject the already-joined parties to a risk of inconsistent obligations--which often means the risk of piecemeal litigation. Neither condition is satisfied in the present case. First, the district court can grant all the relief sought by DAI in this case--an order compelling arbitration--regardless of whether DAI's development agents (nonparties to the arbitration agreement) are present. Second, the other consideration set forth in Rule 19(a)--possible prejudice resulting from piecemeal litigation--is overcome in this context by the FAA's strong bias in favor of arbitration. Indeed, the Supreme Court has categorically stated that the FAA requires courts to enforce an arbitration agreement "notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration agreement." *Moses H. Cone*, 460 U.S. at 20. A district court should not consider the citizenship of strangers to the arbitration contract, since they

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[6] Rule 19(a) provides that

> A person who is subject to service of process and whose joinder will not deprive the court of jurisdiction over the subject matter of the action shall be joined as a party in the action if (1) in the person's absence complete relief cannot be accorded among those already parties, or (2) the person claims an interest relating to the subject of the action and is so situated that the disposition of the action in the person's absence may (i) as a practical matter impair or impede the person's ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring double, multiple, or otherwise inconsistent obligations by reason of the claimed interest.

are not "parties" the suit arising out of the controversy within the meaning of the FAA.

Accordingly, we hold that the district court was correct in looking only to the citizenship of the parties in the action before it--that is, DAI and the franchisees, who signed the arbitration agreement--to determine whether there was complete diversity. (JA 643) Because the parties conceded at oral argument that DAI and the franchisees are completely diverse, we affirm the district court's finding that it possessed subject matter jurisdiction pursuant to 28 U.S.C. § 1332 and 9 U.S.C. § 4.

B. *Preclusive Effect of State Court Judgments*

The franchisees claim that the district court should have accorded full faith and credit to the various state court judgments that found the arbitration clause unenforceable in cases involving DAI and various of the defendant franchisees.

The full faith and credit statute, 28 U.S.C. § 1738, provides that "[state] judicial proceedings . . . shall have the same full faith and credit in every court within the United States . . . as they have by law or usage in the courts of such State . . . from which they are taken." Accordingly, a federal court must "give preclusive effect to state-court judgments whenever the courts of the State from which the judgments emerged would do so." *Allen v. McCurry*, 449 U.S. 90, 96 (1980); *Valley Disposal, Inc. v. Central Vermont Solid Waste Management Dist.*, 31 F.3d 89, 98 (2d Cir. 1994).

The parties agree that the question, therefore, is whether the various state court judgments (one in Alabama, eight in Illinois, and one in North Carolina) would be accorded preclusive effect under Alabama, Illinois, or North Carolina law, respectively. We address each state's law in turn.

1. *The Alabama Judgment (Case # 8)*

During October 1993, DAI's real-estate leasing company and its equipment leasing company filed suit against franchisee John McCrary in the Circuit Court of Talladega County,

Alabama. In December 1993, McCrary filed a counterclaim against those DAI affiliates, and added DAI and its Alabama development agents as cross-claim defendants. On January 25, 1994, DAI and its affiliates filed a motion to dismiss the counterclaims and cross-claims or, in the alternative, to stay the Alabama case pending arbitration. DAI claims that it withdrew that motion after filing its petition to compel arbitration in the district court in Connecticut on March 8, 1994. On June 28, 1994, McCrary filed in the Alabama court a "Motion to Determine Non-Arbitrability of Issues."

On July 7, 1994, the Alabama Circuit Court ruled that the arbitration clause was void and unenforceable "for any of the following independent reasons": (1) lack of mutuality; (2) fraudulent inducement; (3) waiver by DAI of the right to invoke the arbitration clause; and (4) invalidity of the clause under Alabama law prohibiting all arbitration agreements, since the agreement lacked a sufficient "interstate nexus" to permit application of the FAA (which preempts state laws invalidating arbitration clauses affecting interstate commerce). The court also held that the issues raised in McCrary's counterclaim fell outside the scope of the arbitration clause. The Alabama court then expressly found "no just reason for delay" and accordingly directed that final judgment be entered in favor of McCrary.

DAI subsequently filed a motion for reconsideration, which the Alabama court denied on September 28, 1994. McCrary represents to this court that DAI subsequently appealed these orders to the Alabama Supreme Court. (The parties have been barred from proceeding with that appeal pursuant to the preliminary injunction entered by the district court on December 9, 1994.)

In an order entered September 29, 1994, denying McCrary's motion to dismiss, the district court declined to give preclusive effect to this Alabama judgment. The court reasoned that because a motion to reconsider the judgment was still pending in state court, there was not yet a final

judgment on the merits. Thus, principles of *res judicata* and collateral estoppel would not apply.

On appeal, DAI concedes that the Alabama ruling was indeed "final" for the purposes of preclusion. Under Alabama law, an order entered upon less than all of the claims presented in an action is a final, appealable order if "the judge makes an express determination that there is no just reason for delay . . . ." *Goza v. Everett*, 365 So. 2d 658, 659 (Ala. 1978). "Alabama courts, like federal courts, generally apply the same test of finality for purposes of preclusion as they do for appealability." *Stone v. Williams*, 970 F.2d 1043, 1055 (2d Cir. 1992), *cert. denied*, 113 S. Ct. 2331 (1993); *see also First Ala. Bank of Montgomery, N.A. v. Parsons Steel, Inc.*, 825 F.2d 1475, 1480 (11th Cir. 1987) (interpreting Alabama law), *cert. denied sub nom. McGregor v. First Ala. Bank of Montgomery*, 484 U.S. 1060 (1988). Because the Circuit Court of Talladega County expressly found that its decision was final and that there was no reason for delay, its July 7, 1994, order was immediately appealable and thus would be accorded preclusive effect under Alabama law as of that date.

DAI urges this court nevertheless to disregard the Alabama judgment, for three reasons. First, DAI argues that the Supreme Court's decision in *Allied-Bruce Terminix Cos. v. Dobson*, 115 S. Ct. 834 (1995), overturned the interstate commerce analysis that provided the Alabama court's fourth rationale for voiding the arbitration clause. The Supreme Court's decision, DAI contends, constitutes an "intervening change in the applicable legal context," *Staten Island Rapid Transit Operating Auth. v. ICC*, 718 F.2d 533, 543 (2d Cir. 1983), that requires a federal court not to accord preclusive effect to the Alabama decision. *See* RESTATEMENT (SECOND) OF JUDGMENTS § 28(2) (1980). Even if *Allied-Bruce* did undermine one rationale supporting the Alabama court's judgment, however, the Supreme Court's decision did not affect the alternate grounds set forth by the court for voiding the arbitration clause. Because the legal context has not shifted at all in these other areas, we cannot reexamine the Alabama judgment.

Second, DAI contends that it was not afforded a "full and fair opportunity to litigate" the arbitration claims in the Alabama court. *See Milltex Indus. Corp. v. Jacquard Lace Co.*, 922 F.2d 164, 168 (2d Cir. 1991); *Stone*, 970 F.2d at 1056. DAI assigns error to three aspects of the procedure followed in the Alabama court, each of which we reject. (1) DAI complains that it was not afforded the right to file a brief in response to McCrary's "Motion to Determine the Non-Arbitrability of the Issues." But as DAI conceded at oral argument before this court, nothing in the record indicates that it ever sought to file such a brief, much less that the Alabama court prevented it from filing one. Absent any evidence to the contrary, we accept the statement in the written order of the Alabama court that "[b]oth sides have thoroughly briefed the issues and provided factual evidence in support of their respective positions." (2) DAI also claims that it was not afforded "meaningful oral argument." Because DAI does not claim that oral argument was completely denied, we dismiss the argument out of hand. This court has held that "[o]ral argument is not a necessary component of due process in all circumstances." *Zaluski v. INS*, 37 F.3d 72, 73 (2d Cir. 1994); *see also FCC v. WJR, The Goodwill Station, Inc.*, 337 U.S. 265, 276 (1949) ("Certainly the Constitution does not require oral argument in all cases where only insubstantial or frivolous questions of law, or indeed even substantial ones, are raised."). Courts have broad discretion to determine how much, if any, oral argument is appropriate in a given case. We will not second-guess the Alabama court's allocation of its time. (3) Finally, DAI argues that the Alabama court drastically misapplied the law. This argument is nothing more than an invitation for this court to revisit the merits of the Alabama court's judgment--precisely what the full faith and credit statute tells us not to do. *See Charles Koen & Assocs. v. City of Cairo*, 909 F.2d 992, 1000 n.8 (7th Cir. 1990) ("The full faith and credit statute does not permit federal courts to reassess the merits of state court judgments."). "Lower federal courts are not superior to state courts." *Lion Bonding & Sur. Co. v. Karatz*, 262 U.S. 77, 90 (1923); *see also District of Columbia Court of Appeals v. Feldman*, 460 U.S. 462, 482

(1983) ("[A] United States District Court has no authority to review final judgments of a state court in judicial proceedings."). If DAI is dissatisfied with the judgment of the Alabama trial court, it should take an appeal.

Third, DAI argues that there was no motion properly before the Alabama court that would permit it to decide the arbitrability issue. That is, DAI claims that it had already withdrawn its own motion to compel arbitration under § 3 of the FAA, and that McCrary's own "Motion to Determine the Non-Arbitrability of the Issues" was unauthorized, considering that McCrary had never sought a declaratory judgment in his complaint. According to DAI, the Alabama opinion is therefore purely "advisory," and is not entitled to preclusive effect under state law. This argument fails for two reasons. First, the Alabama court clearly believed that DAI's motion to dismiss had been submitted for decision, since it denied that motion on the merits. Second, *Stamps v. Jefferson County Board of Education*, 642 So. 2d 941, 944 (Ala. 1994), which DAI cites, does not support the proposition that a declaratory judgment is merely "advisory" if such relief was not specifically requested in the complaint. All the Alabama Supreme Court stated in *Stamps* was that "[a]ctions or opinions are denominated 'advisory,'. . . where the judgment sought would not constitute specific relief to a litigant . . . ." 642 So. 2d at 944 (quoting EDWIN M. BORCHARD, DECLARATORY JUDGMENTS 34 (1934)) (emphasis deleted). In that case, a group of teachers had sued their employer and sought a judicial declaration that their work duties subjected them to prosecution by a state agency. The court held that such a declaratory judgment would be purely advisory because the prosecutorial agency had not been joined as a party, and thus would not be bound by the decision. *Id.* But DAI is a party in the Alabama action, and is bound by the state court judgment. Because the declaratory judgment finding the arbitration clause to be unenforceable provides "specific relief" to McCrary against DAI, as required by *Stamps*, it cannot be brushed aside as an "advisory" opinion.

For these reasons, we hold that the district court should have accorded full faith and credit to the Alabama judgment.

Accordingly, we reverse the district court orders denying McCrary's motion to dismiss and compelling him to pursue arbitration. On remand, we direct the district court to dismiss DAI's petition to compel McCrary to arbitrate. Although McCrary did not appeal from the December 9, 1994 order entering the preliminary injunction, we nevertheless exercise our pendent appellate jurisdiction in the interests of judicial economy to vacate the injunction. *See Golino v. City of New Haven*, 950 F.2d 864, 868 (2d Cir. 1991) ("[W]here we have jurisdiction to consider some questions on appeal, we may exercise our discretion to take pendent jurisdiction over related questions."), *cert. denied sub nom. Lillis v. Golino*, 112 S. Ct. 3032 (1992).

2. *The Illinois Judgments (Cases ## 1-6, 15-16, DAI v. Bickel)*

Eight groups of Illinois franchisees[7] filed complaints against DAI, its leasing companies, and DAI's two co-owners, and their cases were eventually consolidated before the Circuit Court of Madison County, Illinois. On October 24, 1994, the Illinois court granted the franchisees' motion for summary judgment, declaring the arbitration clause void and unenforceable on several grounds. The court stated that its decision was a "final and appealable order and judgment under Illinois Supreme Court Rule 304(a) in that there is no just reason for delaying either the enforcement of or the appeal from this judgment and order."

DAI represented to the district court that it had filed a motion for reconsideration in the Illinois court, and that the possibility of appeal remained open. Reasoning that a judgment subject to appeal was not final under Illinois law, the district court refused to accord preclusive effect to the Illinois court's decision. The district court relied on *Pelon v. Wall*, 262 Ill. App. 3d 131, 135 (2d Dist. 1994), which held that "[f]or res

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[7] Cases 1, 2, 3, 4, 5, 6, 15, 16, and *DAI v. Bickel*. *See supra* note 2 for the list of franchisees involved in each case listed here.

judicata purposes, a judgment is not final until the possibility of appellate review has been exhausted."

The Bickels also filed a complaint against DAI and others in the Circuit Court of Madison County, on December 16, 1994. DAI failed to enter an appearance in Madison County within the prescribed time, so the Illinois court entered a default judgment in favor of the Bickels on February 7, 1994. In its judgment, the Illinois court declared the arbitration clause void and unenforceable, and scheduled a hearing on damages for April 4, 1995. On February 13, 1995, however, the district court ruled that for the purposes of issue preclusion, the Illinois judgment obtained by the Bickels was no more final than the judgment obtained by the other franchisees in Madison County. Accordingly, the district court granted DAI's petition to compel arbitration and enjoined the Bickels from continuing their Illinois litigation. The injunction contained an exception, however, which permitted DAI to move the Illinois court to set aside its default judgment.

The Illinois Supreme Court has held that an Illinois judgment is not final, and thus not entitled to preclusive effect, until the time for appeal has expired. *Bellweg v. City of Springfield*, 114 Ill. 2d 107, 113 (1985) ("For purposes of applying the doctrine of collateral estoppel, finality requires that the potential for appellate review must have been exhausted."); *Relph v. Board of Educ.*, 84 Ill. 2d 436, 442 (1981) (holding that an appellate court's mandate to remand with instructions for further proceedings establishes the law of the case, but does not constitute a final judgment entitled to res judicata effect--partially because the trial court's further proceedings are subject to subsequent appeal, and partially because the appellate court's mandate is subject to review by the Illinois Supreme Court); *see also People v. Condon*, 246 Ill. App. 3d 74, 76 (2d Dist. 1993) (holding that judgment is not final for purposes of preclusion until the potential for appellate review has been exhausted).

The franchisees respond by citing *Illinois Founders Insurance Co. v. Guidish*, 248 Ill. App. 3d 116, 120 (1st Dist. 1993), where it was said that

> [t]he pendency of an appeal has no effect on the finality of the order appealed from. Under certain circumstances, the pendency of an appeal can affect the enforceability of a judgment . . . but not its finality. More to the point, a final judgment can serve as the basis to apply the doctrines of res judicata and collateral estoppel even though the judgement is being appealed.

The Illinois Appellate Court's statement in *Guidish* is clearly at odds with the Illinois Supreme Court's categorical statements in *Bellweg* and *Relph*. *See Prymer v. Ogden*, 29 F.3d 1208, 1213 n.2 (7th Cir.) (discussing, but declining to resolve, conflict in authority), *cert. denied*, 115 S. Ct. 665 (1994). Despite the best efforts of the franchisees to distinguish *Bellweg* and *Relph*, we must follow the rulings of the Illinois Supreme Court.[8]

We hold that the district court correctly refused to accord preclusive effect to the Illinois judgments.

3. *North Carolina (Case #7)*

In April 1993, Michael Johnson filed a complaint against DAI and several affiliated individuals in the General Court of Justice, Superior Court Division, in Gaston County, North Carolina. Johnson alleged, *inter alia*, fraud, breach of contract, and conversion. DAI replied by filing two motions. First, it moved to stay the lawsuit pending arbitration. Second, it moved to dismiss Johnson's complaint, on the grounds that he had waived his right to challenge the arbitration agreement by previously participating in arbitration proceedings with DAI. Johnson, in turn, claimed that the arbitration clause was unenforceable on several grounds, including (1) that it lacked mutuality and (2) that he had been fraudulently induced into executing the arbitration agreement.

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[8] We note that many of the franchisees' arguments were espoused in a *dissenting opinion* by a judge on the Illinois Appellate Court, who directly criticized the holding of *Bellweg* for deviating from the Restatement (Second) of Judgments § 13. *Southeastern Ill. Elec. Coop., Inc. v. Illinois Human Rights Comm'n*, 162 Ill. App. 3d 806, 814 (5th Dist. 1987) (Karns, J., dissenting), *appeal denied*, 119 Ill. 2d 575 (1988).

On May 3, 1994, the North Carolina court denied both of DAI's motions. In its written order, the court explicitly addressed only the issues raised in DAI's motion to dismiss: it held that Johnson's "limited participation in the arbitration proceedings did not constitute a waiver of his right to challenge the enforceability of the arbitration clause." With respect to DAI's *first motion*, however, the court did not explain why it denied the stay, nor did it make any findings of fact or conclusions of law regarding the arbitration clause.

Johnson argues that the North Carolina court *must* have relied on one of the rationales offered by Johnson (lack of mutuality or fraudulent inducement) even though the court did not specify which one. In North Carolina, however, collateral estoppel only precludes the relitigation of issues that were actually and necessarily decided in the earlier action. *King v. Grindstaff*, 200 S.E.2d 799, 805 (N.C. 1973). The party invoking the benefit of collateral estoppel (here, Johnson) bears the burden of establishing what was in fact determined by the prior judgment. *Thomas M. McInnis & Assocs., Inc. v. Hall*, 349 S.E.2d 552, 557 (N.C. 1986). Even if one of the issues raised by Johnson--mutuality or fraudulent inducement--was *necessarily* decided by the state judge, it is impossible to ascertain which issue was *actually* decided. We therefore hold that the judgment of the Gaston County court would not be accorded preclusive effect under North Carolina law with respect to the validity of the arbitration clause.

Accordingly, we affirm the district court's decision not to accord full faith and credit to the judgment against DAI obtained by Johnson in the North Carolina court.[9]

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[9] The district court refused to give full faith and credit to the North Carolina judgment on the grounds that it was subject to appeal, and thus did not constitute a final order entitled to preclusive effect. On appeal before this court, DAI concedes and we agree that the North Carolina judgment is a "final" order for the purposes of North Carolina preclusion law. *Sims v. Ritter Constr., Inc.*, 62 N.C. App. 52, 55, 302 S.E.2d 293, 295 (1983) (holding that interlocutory order affecting a substantial right is final and appealable, and entitled to *res judicata* effect under North Carolina law).

C. *The Franchisees' Challenges to the Arbitration Clause*

1. *Mutuality*

The franchisees argue that the arbitration clause is void for lack of mutuality, in that it requires a franchisee to submit all controversies to arbitration but reserves to DAI (through its leasing companies) the right to seek summary eviction against the franchisees. The district court rejected this argument, finding no lack of mutuality: If the leasing companies were separable entities, then "the arbitration clause will be enforceable only as to DAI and the [franchisees], obliging them to arbitrate, thus establishing mutuality." If, on the other hand, the leasing companies were indistinguishable from DAI, then they too would be bound to arbitrate. Either way, the court reasoned, mutuality was not an issue.

We agree that mutuality is not an issue, but for different reasons. Preliminarily, we note that the parties have not offered any reason why we should not apply the choice-of-law clause in the franchise agreements, which indicates that Connecticut law applies. Connecticut courts, however, have not addressed the precise question whether an arbitration clause may be void for "lack of mutuality."

The term "mutuality" can refer to several different concepts in contract law. Although it is unclear whether the franchisees are referring to "mutuality of obligation" or "mutuality of remedy," both doctrines are largely dead letters. The doctrine of "mutuality of obligation" requires a valid contract to be based on an exchange of reciprocal promises. 1A ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 152, at 3 (1963). As applied to arbitration clauses, that rule has been restated to mean that "the consideration exchanged for one party's promise to arbitrate must be the other party's promise to arbitrate." *Hull v. Norcom, Inc.*, 750 F.2d 1547, 1550 (11th Cir. 1985) (interpreting New York law). But "mutuality of obligation" has been largely rejected as a general principle in contract law, as well as in the arbitration context. The latest Restatement of Contracts provides that "[i]f the requirement

of consideration is met, there is no additional requirement of . . . 'mutuality of obligation.'" RESTATEMENT (SECOND) OF CONTRACTS § 79 (1979). Option contracts, for example, are unquestionably valid under this modern rule despite their lack of "mutuality of obligation." That is, one party's promise to honor a future offer to purchase an item is valid if supported by the other party's present payment of a sum of money. The promise to *accept* the offer need not be supported by a reciprocal promise to *make* that offer. The New York Court of Appeals essentially adopted the Second Restatement position in a case involving a challenge to an arbitration clause which bound only one of the parties to arbitrate. In *Sablosky v. Edward S. Gordon Co.*, 73 N.Y.2d 133, 137, 538 N.Y.S.2d 513, 516 (1989), the court held that

> [i]f there is consideration for the entire agreement that is sufficient; the consideration supports the arbitration option, as it does every other obligation in the agreement. . . . Since it is settled that the validity of an arbitration agreement is to be determined by the law applicable to contracts generally . . . there is no reason for a different mutuality rule in arbitration cases.

Most courts facing this issue have arrived at the same conclusion. *See, e.g., Wilson Elec. Contractors, Inc. v. Minnotte Contracting Corp.*, 878 F.2d 167, 168 (6th Cir. 1989); *Becker Autoradio U.S.A., Inc. v. Becker Autoradiowerk GmbH*, 585 F.2d 39, 47 (3d Cir. 1978); *W.L. Jorden & Co. v. Blythe Indus.*, 702 F. Supp. 282, 284 (N.D. Ga. 1988); *Willis Flooring, Inc. v. Howard S. Lease Constr. Co. & Assocs.*, 656 P.2d 1184, 1185 (Alaska 1983) ("As one clause in a larger contract, the [arbitration] clause is binding to the same extent that the contract as a whole is binding."); *LaBonte Precision, Inc. v. LPI Indus. Corp.*, 507 So. 2d 1202, 1203 (Fla. Dist. Ct. App. 1987); *Kalman Floor Co. v. Jos. L. Muscarelle, Inc.*, 196 N.J. Super. 16, 481 A.2d 553 (1984), *aff'd for reasons stated below*, 98 N.J. 266, 486 A.2d 334 (1985). *Contra Stevens/Leinweber/Sullens, Inc. v. Holm Dev. & Management, Inc.*, 795 P.2d 1308, 1313 (Ariz. Ct. App. 1990); *R.W.*

Roberts Constr. Co. v. St. Johns River Water Management Dist., 423 So. 2d 630, 633 (Fla. Dist. Ct. App. 1982).

It has been argued that, according to the Supreme Court's decision in *Prima Paint Corp. v. Flood & Conklin Manufacturing Co.*, 388 U.S. 395, 403-04 (1967), an arbitration clause is separable from its underlying contract, and therefore must be supported by separate consideration. *Stevens*, 795 P.2d at 1312-13. In *Prima Paint*, the Court held that a claim of fraud in the inducement of an underlying contract must be left to the arbitrators, but that a claim of fraud in the inducement of the arbitration clause should be decided by the court. *Prima Paint*, 388 U.S. at 403-04. In reaching this conclusion, the Court endorsed the result reached by our court in *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402 (2d Cir. 1959) (Medina, J.), *cert. granted*, 362 U.S. 909, *cert. dismissed for mootness*, 364 U.S. 801 (1960).[10] In *Robert Lawrence*, we described the FAA as distinguishing between "the entire contract between the parties on the one hand and the arbitration clause of the contract on the other," 271 F.2d at 409--the latter being described as a "separable part of the contract." *Id.* at 410. At one point in *Robert Lawrence*, we speculated that

> we would suppose that generally where the arbitration provision of the contract is sufficiently broad to encompass the issue of fraud, the mutual promises to arbitrate would form the *quid pro quo* of one another and constitute a separable and enforceable part of the agreement. We do not decide this point, however, as it is not necessarily before us.

Id. at 411. This passage, one might argue, indicates that an arbitration clause must be treated as a contract supported by independent consideration. For the following reasons, however, we reject this characterization.

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[10] *Prima Paint*, 388 U.S. at 400 ("We agree [with the result reached in *Robert Lawrence*], albeit for somewhat different reasons. . . .")

First, of course, we clearly labelled our statement in *Robert Lawrence* as dicta. Second, though we suggested that mutual promises to arbitrate could constitute sufficient consideration to support an arbitration agreement, we did not exclude the possibility that other consideration could support the agreement. Third, we indicated only that arbitration clauses are "separable" from void or voidable provisions of a contract--not that they are independent contracts. Although we consider an arbitration clause separately for the limited purpose of evaluating a claim of fraudulent inducement, we do not do so for all purposes. For example, when determining the parties' intent in the arbitration clause, we must read the contract as a whole. *Mastrobuono v. Shearson Lehman Hutton, Inc.*, 115 S. Ct. 1212, 1217 (1995) (quoting RESTATEMENT (SECOND) OF CONTRACTS. § 202(2) (1979)). State law generally governs the determination of whether the parties agreed to arbitrate a certain matter, *First Options of Chicago, Inc. v. Kaplan*, 115 S. Ct. 1920, 1924 (1995), and Connecticut courts "construe the contract as a whole" and consider "all relevant provisions . . . when determining the intent of the parties." *White v. Kampner*, 641 A.2d 1381, 1385 (Conn. 1994).

Wilson Electrical Contractors, Inc. v. Minnotte Contracting Corp., 878 F.2d 167, 169 (6th Cir. 1989), rejected the contention that under *Prima Paint*, "an arbitration clause is an independent contract that is separable from the main contract in which it is found and therefore must have all of the essential elements of a contract, including consideration." As the *Wilson* court pointed out, more recent decisions of the Supreme Court have consistently emphasized that the FAA is grounded in a strong federal policy favoring arbitration. *Id.* at 169. A doctrine that required separate consideration for arbitration clauses might risk running afoul of that policy. In any event, because the franchisees make no claim that the underlying contract was the result of fraud, we have no occasion to consider the arbitration clause in isolation from the larger contract. Accordingly, we need not decide whether the arbitration clause must be supported by independent consideration.

The doctrine of "mutuality of remedy" affords no greater relief for the franchisees. That rule, which provides generally that a "plaintiff shall not get specific enforcement unless the defendant could also have obtained it," 5A ARTHUR L. CORBIN, CORBIN ON CONTRACTS § 1181, at 336 (1964), is also defunct. *See, e.g., Sablosky*, 73 N.Y.2d at 137 ("Mutuality of remedy is not required in arbitration contracts."). As explained in the latest Restatement,

> the law does not require that the parties have similar remedies in case of breach, and the fact that specific performance or an injunction is not available to one party is not a sufficient reason for refusing it to the other party. The rationale of the supposed requirement of "mutuality of remedy" is to make sure that the party in breach will not be compelled to perform without being assured that he will receive any remaining part of the agreed exchange from the injured party. It is therefore enough if adequate security can be furnished.

RESTATEMENT (SECOND) OF CONTRACTS § 363 cmt. c (1979).

In view of Connecticut's strong policies favoring arbitration, *see, e.g., White v. Kampner*, 229 Conn. 465, 471, 641 A.2d 1381, 1384 (1994); *Garrity v. McCaskey*, 223 Conn. 1, 7, 612 A.2d 742, 746 (1992), we believe that the Connecticut courts would conclude that "where the agreement to arbitrate is integrated into a larger unitary contract, the consideration for the contract as a whole covers the arbitration clause as well." *W.L. Jorden & Co.*, 702 F. Supp. at 284. The franchisees do not contest that the franchise agreement as a whole is supported by consideration. Absent a failure of consideration, in this instance, we cannot invalidate the agreement in whole or in part.

2. *Waiver of Right to Pursue Arbitration*

The district court held that regardless of whether the leasing companies were DAI's alter egos, DAI had not waived its

right to compel arbitration under the franchise agreement. On the one hand, if the leasing companies were not DAI's alter egos, then their pursuit of eviction proceedings against the franchisees could not be imputed to DAI. On the other hand, even if the leasing companies were DAI's alter egos, DAI nevertheless invoked its arbitration rights as soon as it was named a party in the various state court actions commenced by the franchisees. Somewhat opaquely, the court held that DAI "cannot be held to have waived a right of arbitration by an after-the-fact holding that it is the alter ego of the leasing companies." We disagree.

There is no authority to support the notion that a party is liable for acts of its alter ego only if a court has previously found that an alter-ego relationship exists. As we have explained in the context of contractual liability, "it is clear that the consequence of applying the alter ego doctrine is that the corporation and those who have controlled it without regard to its separate entity are treated as but one entity, and . . . the acts of one are the acts of all." *Fisser v. International Bank*, 282 F.2d 231, 234 (2d Cir. 1960) (holding parent corporation bound to arbitrate, where its alter-ego instrumentality signed arbitration agreement); *see also Interocean Shipping Co. v. National Shipping & Trading Corp.*, 523 F.2d 527, 539 (2d Cir. 1975) (holding that company may be compelled to arbitrate even if not party to agreement containing arbitration clause, where company is alter ego of another party that clearly is subject to arbitration), *cert. denied*, 423 U.S. 1054 (1976). We believe that this principle applies with equal force in the present context. If DAI and its leasing companies should be treated as one and the same, then the initiation of eviction proceedings by the leasing companies must be imputed to DAI.

There remain two further questions: (1) whether the district court or the arbitrators should determine the waiver issue, and (2) what standard should be used by the appropriate decisionmaker. As to the first question, we note that the defense of waiver is generally referable to the arbitrators in cases involving petitions to compel under § 4 of the FAA--with one

important exception which we shall shortly explain. In *World Brilliance Corp. v. Bethlehem Steel Co.*, 342 F.2d 362 (2d Cir. 1965), we squarely held that issues of waiver, like issues of fraud in the inducement of the entire contract, were properly resolved by the arbitrators, not the district court. *Id.* at 364-65. In reaching this conclusion, we pointed out that § 2 of the FAA makes an arbitration agreement enforceable "'save upon such grounds as exist at law or in equity for the revocation of any contract.'" *Id.* at 364 (quoting 9 U.S.C. § 2). Waiver, we explained, does not constitute a ground for "revocation" of a contract within the meaning of § 2, and thus is not a basis for invalidating an arbitration contract. *Id.* Likewise, we explained that under § 4, a court is required to grant a petition to compel arbitration except where a question of fact exists as to (1) "the making of the arbitration agreement" or (2) the "failure, neglect, or refusal of *another* [i.e., the respondent to the § 4 petition] to arbitrate." *Id.* at 364-65 (quoting 9 U.S.C. § 4 (emphasis added)). Because acts *by the petitioner* constituting waiver of the right to arbitrate did not fall within either of these enumerated categories, a district court cannot refuse to order arbitration under § 4 on a theory of waiver. *Id.* at 365. We reaffirmed this restrictive interpretation of § 4 in *Trafalgar Shipping Co. v. International Milling Co.*, 401 F.2d 568, 571 (2d Cir. 1968), where we held that most questions regarding the defense of laches should be decided "by the arbitrators, not the courts." In that case, we repeated that "[t]he only issues which the court is authorized to consider on a motion to compel arbitration are ones which pertain to 'the making of the arbitration agreement or the failure, neglect, or refusal to perform the same,'" *id.* at 571, and that the latter phrase referred to the failure of the *respondent* in a § 4 action to submit to arbitration, *id.* at 572.

Our decision in *World Brilliance* did not call into question, however, a parallel line of cases that considers waiver to be an equitable defense to a stay application under § 3 of the FAA, which a court is empowered to consider. Section 3 authorizes a court to stay proceedings pending arbitration, "providing the applicant for the stay is not in default in proceeding with such arbitration." 9 U.S.C. § 3. For example, in *Kulukundis*

Shipping Co. v. Amtorg Trading Corp., 126 F.2d 978 (2d Cir. 1942), a defendant sought to amend his answer nine months into the litigation and two months before trial, raising for the first time the defense that the case was arbitrable. *Id.* at 986. We construed the defendant's motion to amend as an application for a § 3 stay of proceedings. *Id.* at 986 n.29. We explained that the proviso in § 3--that a stay shall be granted "providing the applicant for the stay is not in default in proceeding with such arbitration"--referred to a party "who, when requested, has refused to go to arbitration or who has refused to proceed with the hearing before the arbitrators once it has commenced." *Id.* at 989. We also noted with approval that, in other courts,

> [a] plaintiff who brought suit on a contract, without seeking to avail himself of its arbitration clause, has been held to have waived his rights thereunder, so that he could not subsequently, after a long delay, ask the court, under Section 3, to stay the action pending arbitration.

Id. We also indicated our agreement with a Fourth Circuit decision finding waiver of the right to arbitrate by a counterclaim defendant who participated at length in litigation, but on the eve of trial moved for a stay under § 3 of the FAA. *Id.* (describing *Radiator Specialty Co. v. Cannon Mills, Inc.*, 97 F.2d 318 (4th Cir. 1938)). The defendant in *Kulukundis* did not waive its right to arbitrate, we held, because it had not pursued litigation as extensively as had the parties in these other cases. 126 F.2d at 989.

We again equated a waiver of the right to arbitrate with a "default in proceeding with such arbitration" under § 3 in *Robert Lawrence*, 271 F.2d at 412; *see Carcich v. Rederi A/B Nordie*, 389 F.2d 692, 696 (2d Cir. 1968) (deciding waiver issue where defendant moved for stay). The Court of Appeals for the District of Columbia Circuit apparently took the same view, when it explained that

> [t]he right to arbitration, like any other contract right, can be waived. A party waives his right to arbitrate

> when he actively participates in a lawsuit or takes other action inconsistent with that right. Once having waived the right to arbitrate, that party is necessarily "in default in proceeding with such arbitration."

Cornell & Co. v. Barber & Ross Co., 360 F.2d 512, 513 (D.C. Cir. 1966) (per curiam).

Yet some of our cases have also recognized that a court may consider a waiver defense to § 4 actions to compel arbitration as well as to § 3 stay applications--seemingly in derogation of our holding in *World Brilliance*. For example, in *Chatham Shipping Co. v. Fertex Steamship Corp.*, 352 F.2d 291, 293-94 (2d Cir. 1965), the petitioner had filed a complaint alleging breach of a contract but then filed a § 4 petition and moved to dismiss the first complaint, before the defendant had even filed an answer. We rejected the respondent's defense of waiver on the merits, even though *World Brilliance* had been decided only seven months earlier. In *Demsey & Associates, Inc. v. S.S. Sea Star*, 461 F.2d 1009, 1017 (2d Cir. 1972), where a defendant in a contract action pleaded arbitration "as an affirmative defense" after trial had been completed, we did not construe it as seeking either a § 3 stay or a § 4 order compelling arbitration. We held that the defendant's failure to raise the arbitration issue until after filing cross-claims, participating in discovery, and going to trial on the merits constituted waiver of its right to arbitrate. *Id.* The court did not discuss its authority for reaching the waiver issue--possibly because the defendant had neither sought a stay under § 3, nor petitioned the court to compel arbitration under § 4. *Id.* Yet in all of the cases cited in *Demsey*, except *Chatham*, the court decided the waiver issue only where a defendant, deep into the litigation, sought a stay of judicial proceedings under § 3 of the FAA. *Id.* at 1017-18.[11]

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[11] *Demsey* cited the following cases: *Carcich v. Rederi A/B Nordie*, 389 F.2d 692 (2d Cir. 1968) (holding no waiver where defendant moved for § 3 stay after participating in discovery and pretrial conferences); *Robert Lawrence*, 271 F.2d 402 (holding no waiver where defendant moved for

(Footnote continued)

Any distinction between § 3 and § 4 actions--never fully explicated--submerged even more deeply by the time this court decided *Sweater Bee by Banff, Ltd. v. Manhattan Industries, Inc.*, 754 F.2d 457 (2d Cir.), *cert. denied*, 474 U.S. 819 (1985). That case involved a defendant who, only after obtaining an adverse ruling on a motion to dismiss pursuant to Rule 12(b)(6) of the Federal Rules of Civil Procedure, sought both a § 3 stay and a § 4 order compelling arbitration. 754 F.2d at 459. Citing *Demsey*, we stated that "[t]he rule of this circuit . . . is that the litigation of substantial issues going to the merits may constitute a waiver of arbitration," *id.* at 461, and proceeded to decide the waiver issue. Shortly thereafter, we faced a similar case involving a defendant who sought to sever certain claims from ongoing litigation and petitioned the court to compel arbitration of those claims under § 4 of the FAA. *Rush v. Oppenheimer & Co.*, 779 F.2d 885, 886 (2d Cir. 1985). We made it clear that "waiver of the right to compel arbitration due to participation in litigation may be found only when prejudice to the other party is demonstrated," *id.* at 887, and again decided the waiver issue. Finally, in *Kramer v. Hammond*, 943 F.2d 176 (2d Cir. 1991), we held that a party bringing a petition to compel under § 4 had waived his right to arbitration by engaging in prior litigation in state courts, not in the district court.[12] *Id.* at 180. Again, the parties did not

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§ 3 stay in the answer); *Reynolds Jamaica Mines, Ltd. v. La Societe Navale Caennaise*, 239 F.2d 689 (4th Cir. 1956) (in what was arguably a § 3 action, finding no waiver and dismissing federal lawsuit because dispute was arbitrable--but not ordering arbitration); *Hilti Inc. v. Oldach*, 392 F.2d 368 (1st Cir. 1968) (holding no waiver where defendant moved for § 3 stay eight months after raising arbitrability as a defense in answer); *Mason v. Stevensville Golf & Country Club, Inc.*, 292 F. Supp. 348 (S.D.N.Y. 1968) (Pollack, J.) (finding no waiver where defendant sought § 3 stay after failing to object to scheduling of trial).

[12] Prior to our decision in *Kramer*, all of the cases in which we reached the issue of waiver involved substantial litigation on the merits in the district court which was asked to grant the § 3 stay, not in other state or federal courts. Our decisions to rule on the waiver issue, rather than to refer the question to the arbitrators, could have been explained as exercises of the federal courts' inherent power to deal with abusive litigation practices in

(Footnote continued)

raise and we did not discuss why this issue was for the courts rather than the arbitrators to resolve.

It would appear that the waiver defense has slowly been transformed from a statutorily mandated inquiry in § 3 cases--whether the "applicant for the stay is . . . in default in proceeding with such arbitration"--into a broader equitable defense in § 4 cases. This trend has its limits, however, and another of our decisions suggests how the equitable waiver defense may be reconciled with our holdings in *World Brilliance*. In *Prudential Lines, Inc. v. Exxon Corp.*, 704 F.2d 59 (2d Cir. 1983), we reaffirmed the holdings of *World Brilliance* and *Trafalgar* that a waiver defense, like a laches defense, was "an arbitrable issue." *Id.* at 67. We noted that in the cases where the court itself decided the issue of waiver, the "party had previously participated in court proceedings to litigate the same dispute." *Id.* at 67 n.8. We therefore distinguished between cases where the waiver defense was based on prior litigation by the party seeking arbitration--when the court should decide the issue of waiver--and those when the defense was based on other actions. It may be that the modern evolution of our waiver

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their courtrooms. *See, e.g., Chambers v. Nasco*, 501 U.S. 32, 44-45 (1991) ("A primary aspect of [a court's] discretion [to exercise its inherent powers] is the ability to fashion an appropriate sanction for conduct which abuses the judicial process."); *Link v. Wabash R.R.*, 370 U.S. 626, 629 (1962) ("The authority of a federal trial court to dismiss a plaintiff's action with prejudice because of his failure to prosecute cannot seriously be doubted.") *Landis v. North Am. Co.*, 9 U.S. 248, 254 (1936) ("[T]he power to stay proceedings is incidental to the power inherent in every court to control the disposition of the causes on its docket with economy of time and effort for itself, for counsel, and for litigants."); *United States v. Hudson*, 7 Cranch 32, 34 (1812) (holding that the inherent powers of federal courts are those which "are necessary to the exercise of all others"). In *Kramer*, however, we reached the question of waiver even though the petitioner had not engaged in prior litigation in the district court. Our precedent therefore teaches that a court's ability to reach the question of waiver as a defense to arbitration is not grounded solely in its ability to control litigation practices before it. In light of *Kramer*, we are bound to hold that a district court may reach the question of waiver whenever a party seeking arbitration has engaged in any prior litigation.

doctrine does not correspond precisely to our understanding of the FAA thirty years ago. Yet we are bound to abide by our most recent precedent. *Cf. Commodity Futures Trading Commission v. Dunn*, 58 F.3d 50, 54 (2d Cir. 1995) (holding that a panel of Court of Appeals may not "disregard the reasoning of a decision [of a prior panel] because an entirely different line of reasoning was available").

Clearly, the present case falls squarely within the parameters of *Kramer v. Hammond*, where the party invoking arbitration (DAI) was allegedly involved in prior litigation in state courts. Pursuant to the distinction we drew in *Prudential Lines*, and consistent with *Kramer*, we hold that the issue of DAI's waiver of arbitration is for the district court to resolve on remand. To do so, the court must evaluate the franchisees' factual contentions, including whether the leasing companies were mere alter egos of DAI. If DAI was responsible for the eviction proceedings, the court must then determine whether prosecution of those eviction actions constituted litigation of "substantial issues going to the merits," *Sweater Bee*, 754 F.2d at 461. This inquiry will require a determination of whether, in fact, the particular eviction proceedings were based on the cross-default provisions of the subleases. If the alleged violations of the subleases were premised on violations of the franchise agreement (which DAI was contractually bound to resolve through arbitration) then DAI did litigate substantial issues going to the merits, and the only remaining question will be whether the franchisees suffered prejudice from the eviction proceedings. *See, e.g., Cotton v. Slone*, 4 F.3d 176 (2d Cir. 1993) (finding prejudice where defendant failed to pursue interlocutory appeal from denial of motion to compel, and instead fully litigated arbitrable issues on the merits in the district court); *Com-Tech Assocs. v. Computer Assocs. Int'l, Inc.*, 938 F.2d 1574, 1576-77 (2d Cir. 1991) (finding prejudice where defendant's extensive litigation before raising issue of arbitration forced plaintiffs to litigate arbitrable claims, and caused considerable expense and delay).

Accordingly, we reverse the district court's order rejecting the franchisees' waiver argument, and remand for further proceedings.

3. *Fraudulent Misrepresentation*

The franchisees argue that DAI fraudulently misrepresented to them that arbitration was a condition precedent to the institution of legal action by either party to the franchise agreement. They argue that DAI had, in reality, reserved the right to bring summary eviction actions against the franchisees through its leasing companies. The franchisees also claim that DAI failed to disclose that it had a custom and practice of bringing summary eviction proceedings and other legal proceedings for alleged violations of the franchise agreement. The district court held that these allegations would be pertinent only if the leasing companies[13] were indeed DAI's alter egos. Both the alter-ego and fraudulent-inducement issues, the court concluded, should properly be left to the arbitrators. This was error.

In *Prima Paint*, 388 U.S. at 403-04, the Supreme Court stated that "if the claim is fraud in the inducement of the arbitration clause itself--an issue which goes to the 'making' of the agreement to arbitrate--the federal court may proceed to adjudicate it." *See also Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 519 n.14 (1974) (citing *Prima Paint* for the proposition that "an arbitration or forum-selection clause in a contract is not enforceable if the *inclusion of that clause in the contract* was the product of fraud or coercion"). As this court has explained, if the "arbitration clause was induced by fraud, there can be no arbitration; and if the party charging this fraud shows there is substance to his charge, *there must be a*

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[13] Although the district court actually referred to the "development agents" as being possible alter egos of DAI, it seems to have meant the "leasing companies." The franchisees do not allege that DAI's various development agents (who engaged in some negotiations on behalf of DAI with the franchisees) were DAI's alter egos.

judicial trial of that question before a stay can issue." *Robert Lawrence*, 271 F.2d at 411.

The franchisees allege that they were fraudulently induced to assent to the arbitration clause--not to the rest of the contract. Accordingly, under *Prima Paint*, the district court had to reach the fraudulent inducement issue before deciding whether to compel arbitration. Resolution of the fraud issue, in turn, will require an answer to the antecedent question of whether the leasing companies were DAI's alter egos.

We therefore reverse the district court's determination that the arbitrators rather than the court should decide the alter-ego and fraudulent-inducement questions. On remand, the district court must resolve these issues.

III. CONCLUSION

To summarize:[14]

1. We affirm the district court's decision that it had subject matter jurisdiction over all of DAI's petitions to compel arbitration, because there was complete diversity between the parties to the arbitration clause.

2. We reverse the district court's holding that the Alabama court's judgment in the *McCrary* case (Case # 8) was not entitled to full faith and credit. That judgment had preclusive effect under Alabama law, and thus barred DAI from seeking to enforce its arbitration agreement with McCrary. We therefore reverse the district court's denial of franchisee McCrary's motion to dismiss DAI's motion to compel and its order granting DAI's petition to compel McCrary to arbitrate. In the exercise of our pendent appellate jurisdiction, we vacate the preliminary injunction barring McCrary from pursuing his Alabama state court claims against DAI. We direct the district court, on remand, to dismiss with prejudice DAI's motion to compel McCrary to arbitrate.

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[14] For the list of cases affected by our ruling, *see supra* note 2.

3. We affirm the district court's holding that the Illinois courts' judgments in Cases ## 1-6, 15-16, and *DAI v. Bickel* were still subject to appeal, and thus under Illinois law were not entitled to preclusive effect. We therefore affirm the district court's denial of those franchisees' motions to dismiss.

4. We affirm the district court's holding that the North Carolina judgment in the *Johnson* case (Case # 7) was not entitled to full faith and credit. That judgment would not be accorded preclusive effect under North Carolina law, because the court's written order does not indicate what issues were actually decided. We therefore affirm the district court's denial of the Johnson franchisees' motion to dismiss.

5. We affirm the district court's holding that "mutuality" was not at issue, but on different grounds. We hold that where consideration supports a contract as a whole, an arbitration clause in that contract is not void for lack of consideration.

6. We reverse the district court's holding that DAI did not waive its right to petition to compel arbitration, and remand for further proceedings. We hold that if the leasing companies were mere alter egos of DAI, their pursuit of eviction proceedings based on violations of the franchise agreements could constitute waiver of DAI's right to demand arbitration.

7. We reverse the district court's decision to defer to the arbitrators on the question of whether DAI fraudulently induced the franchisees to enter into the arbitration agreement. On remand, the district court must decide this issue.

8. Because the district court should have decided the alter-ego, waiver and fraudulent-inducement issues, we reverse its order granting DAI's motion to compel arbitration in all cases and remand for further proceedings. We also reverse its entry of preliminary injunctions against all of the franchisees --including, in the exercise of our pendent appellate jurisdiction and in the interests of judicial economy, the Alabama franchisees.

9. Finally, because we reverse the district court's orders entering the preliminary injunctions, we need not address the franchisees' contention that those orders violated the Anti-Injunction Act.

APPENDIX B

[Filed September 28, 1995]

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

Nos. 1724, 1725, 1726, 1988 August Term, 1994

Docket Nos. 94-9207, 94-9293, 94-9209, 95-7183

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

v.

EMILY DISTAJO, RENATO DISTAJO, CONSTANTINO LAMANDO, MILO LAMANDO, JOSE ALBERTO BRENES, ALVARO GUERRERO, MARIA T. GUERRERO, WESAM S. YOUMARAN, LINDA YOUMARAN, JULIE SHINO, JOHNSON SHINO, ALBERT YONAN, LEYLAH YONAN, LOUIS LOENNEKE, MARY ANN BOOKOUT, MICHAEL JOHNSON, DEBORAH A. KANE, GREGORY F. KANE, BRUNO GIANNINI, RONALD ROTHMUND, PATRICIA ROTHMUND, JOHN S. PAPALEO, JOHN A. McCRARY, JOHN GILLON, SONYA SMITH, PAUL RIISE, MELISSA RIISE, and RHONDA BENTON,

Defendants-Appellants.

and

DOCTOR'S ASSOCIATES, INC.,

Plaintiff-Appellee,

v.

RAYMOND BICKEL and SANDRA BICKEL,

Defendants-Appellants.

Present: MINER, LEVAL and CABRANES, *Circuit Judges*.

ORDER

IT IS HEREBY ORDERED that the opinion filed on September 12, 1995, be amended as follows:

Slip op. at 7162, line 30 from top: Insert footnote 13 after "remand."

Slip op. at 7162, bottom of page: Insert "[13]By so holding, we do not purport to reach the question of *how* the district court should resolve this issue. The defendants' jury demands should be considered by the district court in the first instance."

Slip op. at 7162, lines 30-31 from top: Delete "To do so, the court must evaluate the franchisees'" and insert "The"

Slip op. at 7162, line 32 from top: Delete ", including" and insert "to be resolved include"

Slip op. at 7162, line 34 from top: Delete "the court must then determine" and insert "it must then be determined"

Slip op. at 7164, line 4 from top: Change footnote number from 13 to 14.

Slip op. at 7164, bottom of page: Change footnote number from 13 to 14.

Slip op. at 7165, line 3 from top: Insert footnote 15 after "questions."

Slip op. at 7165, bottom of page: Insert "[15]*See supra* note 13."

Slip op. at 7165, line 6 from top: Change footnote number from 14 to 16.

Slip op. at 7165, bottom of page: Change footnote number from 14 to 16.

IT IS SO ORDERED:

FOR THE COURT.

/s/ George Lange III, Clerk

APPENDIX C

[Filed Sep. 29, 1994]

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

DOCTOR'S ASSOCIATES, INC. :

-vs- : Civil No. 3:94CV00349 (PCD)

EMILY DISTAJO, ET AL. :

RULING ON PENDING MOTIONS

Plaintiff filed a petition to compel arbitration pursuant to the Federal Arbitration Act (FAA) 9 U.S.C. § 4, and subsequently an application for a Temporary Restraining Order and a Preliminary Injunction. Defendants have filed various motions to dismiss, to transfer, and for a hearing on the matter.

BACKGROUND

Plaintiff Doctor's Associates, Inc. (DAI) is the national franchisor of "Subway" sandwich shops, and is a Florida corporation. DAI entered into written franchise agreements with defendants, permitting them to operate a Subway restaurant. The agreements contain an arbitration clause (paragraph 10c) which reads as follows:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out or relating to this contract is a condition precedent to the commencement of legal action by either party.

> The cost of such a proceeding will be borne equally by the parties.

Defendants have filed suit against plaintiff, affiliated individuals and entities in various state courts. Plaintiff demanded arbitration of defendants' claims by the American Arbitration Association in accordance with the arbitration clause. Defendants have refused to arbitrate, and therefore plaintiff petitions here for an order directing defendants to arbitrate. Plaintiff moved for a temporary restraining order and for a preliminary injunction to stay the state court proceedings until this court could rule on the petitions to compel arbitration. On September 13, 1994 a hearing was held as to whether a preliminary injunction should enter. The temporary restraining order has expired.

DISCUSSION

1) *Motions for a Hearing*

Plaintiff's motions for a hearing on the petition to compel arbitration and on the motions to dismiss are denied.

2) *Motions to Dismiss*

A motion to dismiss under Rule 12(b)(6) must be decided solely on the facts alleged. *Goldman v. Belden*, 754 F.2d 1059, 1065-66 (2d Cir. 1985). Such a motion should be granted only where no set of facts consistent with the allegations could be proven entitling plaintiffs to relief. *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957). The issue is not whether plaintiffs will prevail, but whether they should be afforded the opportunity to offer evidence to prove their claims. *Id.*

A) *Local Rule 9*

The motions to dismiss filed in 3:94cv00370 *Doctor's Associates v. Smith* (doc. #5) and 3:94cv00369 *Doctor's Associates v. Gillon* (doc. #7) are denied for failure to file an accompanying memorandum of law as required by Local Rule 9.

B) *Subject Matter Jurisdiction*

Several of the defendants claim that this court does not have jurisdiction over the subject matter of the action because there is not complete diversity, as certain development agents of DAI doing business in the same states that defendants reside must be joined as plaintiffs in the various actions.[1] However, they are not parties to the contract that is at issue in the instant action. "Fed.R. Civ.P. 19 does not require the joinder of parties merely because they played some part in the underlying events of a dispute, but only if such parties are necessary in order to grant complete relief or if they would be prejudiced by not being joined." *Argo Partners, Inc. v. Littlefield, Adams & Co.*, 1994 WL 320616 (S.D.N.Y.). "Under the Arbitration Act, an arbitration agreement must be enforced notwithstanding the presence of other persons who are parties to the underlying dispute but not to the arbitration

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[1] Defendants in 3:94cv00515 *Doctor's Associates v. Youmaran*, 3:94cv00803 *Doctor's Associates v. Brenes*, 3:94cv00514 *Doctor's Associates v. Guerro*, 3:94cv00516 *Doctor's Associates v. Shino*, 3:94cv00517 *Doctor's Associates v. Loenneke*, 3:94cv00349 *Doctor's Associates v. Distajo*, 3:94cv01457 *Doctor's Associates v. Papaleo* and 3:94cv01456 *Doctor's Associates v. Rothmund* are residents of Illinois. They allege that Phil Mesi and Subway Development of Chicagoland, Inc., both development agents of DAI and residents of Illinois, are indispensable parties under Fed.R.Civ.P. 19(b). Defendants in 3:94cv00998 *Doctor's Associates v. Kane* are residents of Massachusetts. They allege that Michael and Jane Eslinger and Jams, Inc., development agents of DAI and residents of Massachusetts, are indispensable parties. Defendant in 3:94cv00803 *Doctor's Associates v. Johnson* is a resident of North Carolina. He alleges that Peter Slomianyj and North Carolina Subway Group, development agents of DAI and residents of North Carolina, are indispensable parties. Defendant in 3:94cv1108 *Doctor's Associates v. Giannini* is a resident of Pennsylvania. He alleges that J.B. Jung and Subway Development Corporation of Philadelphia, development agents of DAI and residents of Pennsylvania are indispensable parties. Defendants in *Doctor's Associates v. McCrary*, *Doctor's Associates v. Gillon*, *Doctor's Associates v. Smith*, *Doctor's Associates v. Riise*, and *Doctor's Associates v. Benton* are residents of Alabama. They allege that Bernardo Frausto and Subway Development of Northern Alabama, development agents for DAI and residents of Alabama are indispensable parties.

agreement." *Moses H.Cone Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 20 (1983). *See also Steinberg & Lyman v. Takacs*, 774 F. Supp. 885 (S.D.N.Y. 1991) (parties to an arbitration agreement must arbitrate even though there are other defendants to the action). There would be no prejudice to the various development agents by not joining them, as they are not parties to the agreement in question and the underlying litigation would proceed as to those parties even if the litigation as to Doctor's Associates and the defendants in this action was stayed. This action to enforce an agreement by the defendants to arbitrate does not require joinder of the additional parties.

The motions to dismiss in 3:94cv00349 *Doctor's Associates v. Distajo* (doc. #s 31, 33, 35, 37, 39 and 46) are denied in their entirety, as they relate solely to this issue of subject matter jurisdiction.

C) *Personal Jurisdiction/Venue*

Defendants contend that this court lacks personal jurisdiction over them and that venue is not proper.[2] These arguments are without merit. In accordance with the arbitration agreement, defendants "subjected [themselves] in advance, to the jurisdiction of the court within whose territorial jurisdiction the arbitration proceedings are to be had . . . ." *Hatzlachh Supply Inc. v. Moishe's Electronics, Inc.*, 828 F. Supp. 178, 185 (S.D.N.Y. 1993) (vacated on other grounds, *Hatzlachh*

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[2] Defendants assert this argument in the following cases:

3:94cv00515 *Doctor's Associates v. Youmaran*

3:94cv00998 *Doctor's Associates v. Kane*

3:94cv00514 *Doctor's Associates v. Guerro*

3:94cv00803 *Doctor's Associates v. Brenes*

3:94cv01108 *Doctor's Associates v. Gianni*

3:94cv00516 *Doctor's Associates v. Shino*

3:94cv00517 *Doctor's Associates v. Loenneke*

3:94cv00349 *Doctor's Associates v. Distajo*

3:94cv00803 *Doctor's Associates v. Johnson*

Supply, Inc. v. Moishe's Electronics, Inc., 848 F. Supp. 25 (S.D.N.Y. 1994)); *Farr & Co. v. Cia. Intercontinental De Navegacion De Cuba*, 243 F.2d 342, 346 (2d Cir. 1957). The arbitration agreement also includes a choice-of-forum clause, stating that the parties are to settle any disputes in Connecticut. Such advance consent waives any objection to personal jurisdiction and venue.

D) *Abstention*

Defendants contend, in a conclusory manner, that this court should decline to exercise jurisdiction over the matter under the doctrine of abstention, citing *Colorado River Water Conservation District v. United States*, 424 U.S. 800, 813-17 (1976).[3] Federal courts generally do not dismiss proceedings merely because the same matter is being litigated in state court. Only exceptional circumstances will compel a federal court to relinquish jurisdiction due to parallel proceedings in state court. *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1, 13-14 (1983). Defendants claim that proceedings in over nine cases in state courts constitute compelling circumstances. There is nothing remarkable about parallel state litigation. Although it is not entirely clear how extraordinary the circumstances must be in order for the court to decline to exercise its jurisdiction in this context, it is clear that parallel proceedings alone is not sufficient. *See Id.*; Erwin Chemreinsky, *Federal Jurisdiction* at 669 (4th ed. 1989) (listing cases in which courts abstained due to varying circumstances). Defendants have not enumerated exceptional

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[3] The following defendants assert this argument:

3:94cv00515 *Doctor's Associates v. Youmaran* (doc. #4)
3:94cv00803 *Doctor's Associates v. Brenes* (doc. #4)
3:94cv00514 *Doctor's Associates v. Guerro* (doc. #4)
3:94cv00516 *Doctor's Associates v. Shino* (doc. #6)
3:94cv00517 *Doctor's Associates v. Loenneke* (doc. #5)
3:94cv00349 *Doctor's Associates v. Distajo* (doc. #18)
3:94cv00998 *Doctor's Associates v. Kane* (doc. #3)
3:94cv01108 *Doctor's Associates v. Gianni* (doc. #4)

circumstances that warrant dismissal in deference to the state court litigation.

E) *Res Judicata and Collateral Estoppel*

Defendant in *Doctor's Associates v. Johnson* alleges that res judicata or collateral estoppel precludes jurisdiction here over the matter because the North Carolina trial court in which a complaint was filed declined to stay the lawsuit. These orders are on appeal, and therefore they do not constitute a final judgment on the merits. Therefore res judicata does not apply. *See Allen v. McCurry*, 449 U.S. 90, 94 (1980). Collateral estoppel applies only to issues decided finally in another forum. *Jim Beam Brands Co. v. Crawford, Ltd.*, 937 F.2d 729, 734 (2d Cir. 1991). Even if these orders were to be considered final, a denial of a motion to stay does not preclude a petition to compel arbitration pursuant to § 4 of the FAA. *See In re Pahlberg Petition*, 131 F.2d 968, 969 (2d Cir. 19).

Defendants in *Doctor's Associates v. McCrary* allege that an Alabama state court has determined the arbitration clause to be void and unenforceable and therefore these issues may not be relitigated in this forum. There is currently pending a motion to reconsider the judgment in the state court. Consequently, there is not a final judgment, as discussed above, and the doctrines of res judicata and collateral estoppel do not apply.

4) *Motion for Preliminary Injunction*

Plaintiffs move for a preliminary injunction to enjoin defendants from moving forward with their respective cases in state court. Defendants claim that this court cannot grant the relief requested under the provisions of 28 U.S.C. § 2283 (the "Anti-Injunction Act").

The Anti-Injunction Act was promulgated to balance the tensions between state and federal courts in a dual system, eliminating inevitable friction that may occur when both state and federal courts entertain proceedings. As the Supreme Court has noted, state proceedings "should normally be

allowed to continue unimpaired by intervention of the lower federal courts, with relief from error, if any, through the state appellate courts and ultimately this Court." *Atlantic Coast Line R. Co. v. Locomotive Engineers*, 398 U.S. 281, 287 (1970).

Injunctions can issue against state proceedings in certain limited situations, "namely, when expressly authorized by statute, necessary in aid of the court's jurisdiction, or necessary to protect or effectuate the court's judgment." *Chick Kam Choo v. Exxon Corp.*, 486 U.S. 140, 146 (1988). The exceptions are narrow and "'not [to] be enlarged by loose statutory construction.'" *Id.* (quoting *Atlantic* 398 U.S. at 146). As there is neither statutory authority for entry of an injunction nor a judgment which the court seeks to effectuate, the question is whether this court can enjoin the state court proceedings in aid of its jurisdiction.

In the present action, the state and federal court have concurrent jurisdiction and consequently neither court is "free to prevent either party from simultaneously pursuing claims in both courts." *Atlantic* 398 U.S. at 295.

> Each court is free to proceed in its own way and in its own time, without reference to the proceedings in the other court. Whenever a judgment is rendered in one of the courts and pleaded in the other, the effect of that judgment is to be determined by application of the principles of res judicata.

Vendo Co. v. Lektro-Vend Corp., 433 U.S. 623, 642 (1977). Additionally, the Supreme Court has limited the "in aid of jurisdiction" exception only to cases in which a federal court acquires jurisdiction over real property, but has not extended it to proceedings involving *in personam* jurisdiction. *Atlantic* 398 U.S. at 295-96. As the state court proceedings do not impair this court's jurisdiction to proceed, and there is no dispute as to real property, an injunction is not appropriate.

Exceptions to the Anti-Injunction Act recognized in the Second Circuit also do not apply to the present situation. The

Act has been found not to apply when state court proceedings have not been instituted. *Standard Microsystems v. Texas Instruments*, 916 F.2d 58, 61 (2d Cir. 1990). However, each of the consolidated cases have pending litigation in a state court, and the act bars "an injunction to stay *proceedings* in a State Court." 28 U.S.C. § 2283 (emphasis added). The Second Circuit has cast doubt as to the validity of another exception formulated in the Seventh Circuit in *Barancik v. Investors Funding corp.*, 489 F.2d 933 (7th Cir. 1973), which allowed an injunction if the state court proceedings were instituted after a motion was filed to enjoin it, but before the court ruled on it. *See Standard Microsystems*, 916 F.2d at 61. The facts here do not support such an argument as the state court litigation was commenced prior to plaintiff's application for a preliminary injunction.

The motion for a preliminary injunction (doc. # 59) is denied as the action does not fall within any of the narrow exceptions to the Anti-Injunction Act. Accordingly, defendants' motions to file responsive pleadings in state court are granted.

Conclusion

The following motions to dismiss are denied:

3:94cv00349 *Doctor's Associates v. Distajo* (doc. #s 4, 18, 31, 33, 35, 37, 39, 46, 53, 84, 86, 89)
3:94cv00369 *Doctor's Associates v. Gillon* (doc. #7)
3:94cv00370 *Doctor's Associates v. Smith* (doc. #5)
3:94cv00511 *Doctor's Associates v. Brenes* (doc. #4)
3:94cv00514 *Doctor's Associates v. Guerro* (doc. #4)
3:94cv00515 *Doctor's Associates v. Youmaran* (doc. #4)
3:94cv00516 *Doctor's Associates v. Shino* (doc. #6)
3:94cv00517 *Doctor's Associates v. Loenneke* (doc. #5)
3:94cv00803 *Doctor's Associates v. Johnson* (doc. #3)
3:94cv00948 *Doctor's Associates v. Kane* (doc. #3)
3:94cv01108 *Doctor's Associates v. Gianni* (doc. #4)
3:94cv01457 *Doctor's Associates v. Papaleo* (doc. #5)

The following motions for a hearing are denied:

3:94cv00349 *Doctor's Associates v. Distajo* (doc. # 21 & 50)

3:94cv00354 *Doctor's Associates v. McCrary* (doc. # 9)

3:94cv00369 *Doctor's Associates v. Gillon* (doc. # 9)

3:94cv00370 *Doctor's Associates v. Smith* (doc. # 8)

3:94cv00371 *Doctor's Associates v. Riise* (doc. # 10)

3:94cv00372 *Doctor's Associates v. Benton* (doc. # 8)

3:94cv00511 *Doctor's Associates v. Brenes* (doc. #8)

3:94cv00514 *Doctor's Associates v. Guerrero* (doc. #8)

3:94cv00515 *Doctor's Associates v. Youmaran* (doc. #8)

3:94cv00516 *Doctor's Associates v. Shino* (doc. #7)

3:94cv00517 *Doctor's Associates v. Loenneke* (doc. #8)

The following motions to file documents in pending state proceedings are granted: *Doctor's Associates v. Distajo* 3:94cv00349 (doc. #s 72, 73, 74, 77, 78, 79, 80). The motion for leave to file a supplemental memorandum of law in support of the motion to dismiss for lack of venue 3:94cv00511 *Doctor's Associates v. Brenes* (doc. #7) is granted, and was considered. The motion to transfer venue, *Doctor's Associates v. Distajo* 3:94cv00349 (#8), is denied. The motion for a preliminary injunction *Doctor's Associates v. Distajo* 3:94cv00349 (#59) is denied.

Any responsive pleadings to the petitions to compel arbitration shall be filed on or before October 14, 1994. The petitions shall be decided on the record as of that date.

SO ORDERED.

Dated at New Haven, Connecticut, this 29th day of September, 1994.

/s/ Peter C. Dorsey

United States District Judge

APPENDIX D

[Filed December 9, 1994]

UNITED STATES DISTRICT COURT

DISTRICT OF CONNECTICUT

DOCTOR'S ASSOCIATES, INC. :

-vs- : Civil No. 3:94CV349 (PCD)

EMILY DISTAJO, ET AL. :

RULING ON PENDING MOTIONS

After entry of a temporary restraining order prohibiting defendants from pursuing various state court actions, a hearing to show cause why a preliminary injunction should not enter was held on November 29, 1994. Defendants[1] move to vacate

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[1] The following defendants bring this motion:

3:94cv01457 *Doctor's Associates v. Papaleo*
3:94cv01456 *Doctor's Associates v. Rothmund*
3:94cv00349 *Doctor's Associates v. Distajo*
3:94cv00516 *Doctor's Associates v. Shino*
3:94cv00514 *Doctor's Associates v. Guerrero*
3:94cv00948 *Doctor's Associates v. Kane*
3:94cv01108 *Doctor's Associates v. Giannini*
3:94cv00803 *Doctor's Associates v. Johnson*
3:94cv00517 *Doctor's Associates v. Loenneke*
3:94cv00515 *Doctor's Associates v. Youmaran*
3:94cv00511 *Doctor's Associates v. Brenes*

The "Alabama defendants" did not join in the motion. They are:

3:94cv00372 *Doctor's Associates v. Benton*
3:94cv00354 *Doctor's Associates v. McCrary*
3:94cv00370 *Doctor's Associates v. Smith*
3:94cv00371 *Doctor's Associates v. Riise*
3:94cv00369 *Doctor's Associates v. Gillon*

the temporary restraining order and oppose plaintiff's motion for preliminary injunction.

Background

Doctor's Associates, Inc. (DAI) the national franchisor of "Subway" sandwich shops, is a Florida corporation. DAI entered into written franchise agreements with defendants, permitting them to operate Subway shops. The agreements contain an arbitration clause (paragraph 10c) which reads:

> Any controversy or claim arising out of or relating to this contract or the breach thereof shall be settled by Arbitration in accordance with the Commercial Arbitration Rules of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut and judgment upon an award rendered by the Arbitrator(s) may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out or relating to this contract is a condition precedent to the commencement of legal action by either party. The cost of such a proceeding will be borne equally by the parties.

Defendants have sued plaintiff, affiliated individuals and entities in various state courts. Plaintiff demanded arbitration of defendants' claims by the American Arbitration Association in accordance with the arbitration clause. Defendants have refused to arbitrate. The matter has been ordered to arbitration. Plaintiff has moved to enjoin defendants from proceeding in state court with parallel litigation.

Discussion

A) *Res Judicata/Collateral Estoppel*

Defendants argue that res judicata and/or collateral estoppel bar this court from deciding the arbitration issue. Specifically, they contend that an October 24, 1994 judgment of an Illinois

state court[2] prevents relitigation of the issue, as Illinois law recognizes a trial court judgment as final for purposes of res judicata and collateral estoppel.

The full faith and credit statute, 28 U.S.C. § 1738 gives state court judgments the same preclusive effect as given by courts of the forum state. *Marrese v. American Academy of Orthopaedic Surgeons*, 470 U.S. 373, 380 (1985). Illinois law thus determines what preclusive effect is to be given to the October 24, 1994 decision.

Under Illinois law, preclusive effect is given to a final judgment on the merits. *Pelon v. Wall*, 262 Ill. App.3d 131, 135 (1994). "For res judicata purposes, a judgment is not final until the possibility of appellate review has been exhausted." *Id.* (citations omitted). Plaintiff has indicated that there is a motion for reconsideration pending in the Illinois case. As that motion is pending, and there is the possibility of appeals, the Illinois judgment does not preclude this court from either acting on the arbitration issue or ordering appropriate measures to effectuate its decisions.

B) *Stay of State Court Proceedings*

1) *Federal Arbitration Act*

Defendants first argue that this court cannot stay the underlying state actions pursuant to § 3 of the Federal Arbitration Act (FAA) as that section only allows a court to stay a case when it has a pending suit before it. As there is no suit currently before the court, it is inappropriate for the court to use this section to stay litigation.

2) *Anti-Injunction Act*

Federal courts are generally prohibited from staying state court proceedings by the Anti-Injunction Statute, 28 U.S.C.

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[2] Defendants also cite certain Alabama decisions. Defendants effected by those decisions do not challenge a preliminary injunction. Those decisions will not be discussed here.

§ 2283. However, the statute provides that "[a] court of the United States may not grant an injunction to stay proceedings in a State court except . . . to protect or effectuate its judgments." *Id.* This exception is applicable where "a federal court has made [a] conclusive ruling[] and [its] effect may be undermined by threatened relitigation in state courts." *Standard MicroSystems v. Texas Instruments*, 916 F.2d 58, 60 (2d Cir. 1990).

It has been held here that any dispute as to DAI, in accordance with the agreement, must be addressed in arbitration. Continued litigation of these issues in parallel state proceedings will undermine, if not moot, this ruling. Further proceedings as to defendants' disputes with DAI, which have been determined not to belong in the courts, but in arbitration, may effect this court's judgment. *Necchi Sewing Machine Sales Corp. v. Carl*, 260 F. Supp. 665, 669 (S.D.N.Y. 1966); *see also McGuire, Cornwell & Blakey v. Grider*, 765 F. Supp 1048, 1052 (D. Colo. 1991); *Hunt v. Mobil Oil Corp.*, 557 F. Supp. 368, 372 (S.D.N.Y. 1983).

Defendants have clearly manifested their intent to proceed with state court litigation despite the order of arbitration of their disputes with DAI. This continued action would impair the integrity of the order of arbitration. An injunction is not inappropriate.

Conclusion

The motion for preliminary injunction (doc. #120) is granted; the motion to vacate the temporary restraining order (doc. #127) is denied. Defendants shall be enjoined from proceeding with all related state court litigation pending arbitration.

SO ORDERED.

Dated at New Haven, Connecticut, this 9th day of December, 1994.

/s/ Peter C. Dorsey

United States District Judge

APPENDIX E

[Filed May 3, 1994]

STATE OF NORTH CAROLINA	)	IN THE GENERAL COURT OF JUSTICE
COUNTY OF GASTON	)	SUPERIOR COURT DIVISION
Michael Johnson,	)	FILE NO. 93 CVS 1324
Plaintiff,	)	
vs	)	ORDER
Doctor's Associates, Inc., et al	)	
Defendants.	)	

FINDINGS OF FACT:

1. This action was commenced by the Plaintiff's filing a complaint seeking damages for misappropriation of funds;

2. The Plaintiff is a franchisee of several Subway Sandwich store franchises in North Carolina. Doctor's Associates is the franchisor;

3. The franchise agreement contains an arbitration clause which provides as follows:

> C. Any controversy or claim arising out of, or relating to this contract, or the breach thereof, shall be settled by arbitration in accordance with the commercial arbitration of the American Arbitration Association at a hearing to be held in Bridgeport, Connecticut, or whichever City in which the company is then headquartered, and judgment upon an award rendered by the arbitrators may be entered in any court having jurisdiction thereof. The commencement of arbitration proceedings by an aggrieved party to settle disputes arising out of, or relating to this contract is a condition precedent to the commencement of legal action by either party.

4. In his complaint, Plaintiff alleges that the arbitration clause is void for illegality, lack of mutuality and fraud;

5. The Defendant Doctor's Associates, Inc., has filed a Motion to Dismiss for failure to state a claim and, in the alternative, a Motion to Stay the Proceedings pending completion of arbitration proceeding;

6. The hearing on these motions was held before the undersigned Judge;

7. After the hearing, the Court entered an order denying the Motion to Dismiss for failure to state a claim and ordering the parties to file supplemental briefs and affidavits on the issue of whether the Plaintiff waived his right to litigate by participating in arbitration;

Based on the evidence presented at the hearing, and as set forth in the supplemental affidavits, and after having considered the arguments of counsel, the Court makes the following additional findings of fact:

1. Doctor's Associates filed a demand for arbitration with the American Arbitration Association (AAA) on or about the 26th day of January 1993;

2. Attorney David W. Smith, III, acting on behalf of the Plaintiff, filed an answer and counterclaim on February 10, 1993, and also submitted a five hundred dollar administrative fee to the AAA;

3. In his answer the Plaintiff denied the allegations in Doctor's Associates' statement for arbitration and in his counterclaim, sought an award of damages based on his contention that an employee of Doctor's Associates had misappropriated the Plaintiff's funds. Plaintiff did not challenge the validity of the arbitration clause or object to the jurisdiction of AAA to arbitrate the parties' claims;

4. On April 7, 1993, Plaintiff filed an objection to the jurisdiction and authority of the AAA to proceed with arbitration. The basis for the objection was that the arbitration

provision in the franchise agreement was void and unenforceable because of illegality, lack of mutuality and fraud;

5. On April 14, 1993, pursuant to Rule 8 of the Commercial Arbitration Rules of the AAA, Plaintiff filed a motion with the AAA to amend its counterclaim. The motion was filed "under protest" and specifically set forth the bases on which the Plaintiff contested the jurisdiction of the AAA to arbitrate the matters. On the same date, the Plaintiff filed with the AAA a motion to appoint additional arbitrators;

6. The AAA is currently holding the matter in abeyance pending the decision of this Court on whether the parties are required to arbitrate or may litigate the issues in dispute;

7. To this point, the AAA has appointed one arbitrator but it has not ruled on the Plaintiff's motions to appoint additional arbitrators or the Plaintiff's motion to file an amended counterclaim;

8. The parties have not exchanged exhibits or witness lists nor has any evidence been taken in the arbitration;

BASED ON THE FOREGOING FINDINGS OF FACT, THE COURT MAKES THE FOLLOWING CONCLUSION OF LAW:

1. This Court has jurisdiction over the parties and the subject matter of this order;

2. The Plaintiff's limited participation in the arbitration proceedings did not constitute a waiver of his right to challenge the enforceability of the arbitration clause;

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that Doctor's Associates' motions to dismiss or to stay these proceedings on the grounds that Plaintiff has waived his right to litigate the issues that are the subject of this action by participation in arbitration are denied.

This the 3rd day of May, 1994.

/s/ John Mull Gardner

Superior Court Judge Presiding

[Filed May 18, 1994]

NORTH CAROLINA GASTON COUNTY MICHAEL JOHNSON, Plaintiff, vs. DOCTORS ASSOCIATES, INC., a Florida Corporation (f/k/a DOCTORS ASSOCIATES, INC., a Connecticut Corporation); FREDERICK DELUCA, an individual; PETER BUCK, an individual; FRANCHISE WORLD HEADQUARTERS, INC., a Connecticut Corporation; PETER SLOMIANYJ, an individual; NORTH CAROLINA SUBWAY GROUP, INC., a North Carolina Corporation; DOUGLAS BENTELLE, an individual; SHEILA HALLETT, an individual; SANTO RHODES, an individual; MICHAEL ARMELLINO, an individual; and NANCY TIMMONS, an individual; Defendants.	IN THE GENERAL COURT OF JUSTICE SUPERIOR COURT DIVISION 93-CvS-1324 **AMENDED ORDER**

Pursuant to Rule 60(a) of the North Carolina Rules of Civil Procedure, the May 3, 1994 Order entered in the captioned matter is hereby amended as follows:

1. Paragraph 5 of the Findings of Fact (beginning on page 1 of the Order) is stricken and is replaced with the following:

> 5. The Defendants Doctors Associates, Inc., Frederick Deluca, Peter Buck, Franchise World Headquarters, Inc., Peter Slomianyj and North Carolina Subway Group, Inc., have filed Motions to Dismiss for failure to state a claim and, in the alternative, Motions to Stay the Proceedings pending completion of arbitration proceedings;

2. Paragraph 7 of the Findings of Fact (on page 2 of the Order) is stricken and is replaced with the following:

> 7. After the hearing, the Court ordered the parties to file supplemental briefs and affidavits on the issue of whether Plaintiff waived his right to litigate by participating in arbitration;

3. The final paragraph of the Order is stricken and is replaced with the following:

> IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the Motions brought by all moving Defendants -- Doctors Associates, Inc., Frederick Deluca, Peter Buck, Franchise World Headquarters, Inc., Peter Slomianyj and North Carolina Subway Group, Inc., -- to dismiss or to stay these proceedings on the grounds that Plaintiff has waived his right to litigate the issues that are the subject of this action by participation in the arbitration are denied.

4. The May 3, 1994 Order shall remain the same in all other respects.

This the 17th day of May, 1994.

/s/ John Mull Gardner

Superior Court Judge Presiding

APPENDIX F

[Filed May 18, 1994]

NORTH CAROLINA GASTON COUNTY	IN THE GENERAL COURT OF JUSTICE
MICHAEL JOHNSON, Plaintiff, vs. DOCTORS ASSOCIATES, INC., a Florida Corporation (f/k/a DOCTORS ASSOCIATES, INC., a Connecticut Corporation); FREDERICK DELUCA, an individual; PETER BUCK, an individual; FRANCHISE WORLD HEADQUARTERS, INC., a Connecticut Corporation; PETER SLOMIANYJ, an individual; NORTH CAROLINA SUBWAY GROUP, INC., a North Carolina Corporation; DOUGLAS BENTELLE, an individual; SHEILA HALLETT, an individual; SANTO RHODES, an individual; MICHAEL ARMELLINO, an individual; and NANCY TIMMONS, an individual; Defendants.	SUPERIOR COURT DIVISION FILE NO. 93-CVS-1324 **ORDER**

THIS MATTER coming on to be heard and being heard before the undersigned Superior Court Judge presiding at the February 28, 1994, Gaston County Civil Term of Court upon

Motions to Dismiss for failure to state a claim under Rule 12(b)(6) of the North Carolina Rules of Civil Procedure; such Motions being brought by defendants Doctors Associates, Inc., Frederick Deluca, Peter Buck, Franchise World Headquarters, Inc., Peter Slomianyj, and North Carolina Subway Group, Inc., by their respective counsel; and it appearing to the Court after arguments by counsel for all parties involved that the Complaint does state a claim;

IT IS THEREFORE ORDERED, ADJUDGED AND DECREED that the moving Defendants' Motions to Dismiss for failure to state a claim pursuant to Rule 12(b)(6) of the North Carolina Rules of Civil Procedure be and hereby are denied.

This the 17th day of May, 1994.

/s/ John Mull Gardner

Superior Court Judge Presiding

APPENDIX G

[Filed November 14, 1995]

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
UNITED STATES COURT HOUSE
40 FOLEY SQUARE
NEW YORK 10007

GEORGE LANGE III
CLERK

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 9th day of November one thousand nine hundred and ninety-five.

Doctor's Associates

Plaintiff-Appellee,

v

Dkt No: 94-9207

Distajo, et al.

Defendants-Appellants.

A petition for rehearing containing a suggestion that the action be *reheard* in banc having been filed herein by the appellant Emily Distajo, et al.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is **DENIED**.

It is further noted that the suggestion for rehearing in banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

GEORGE LANGE III, Clerk

By: /s/ Beth J. Meador,

Administrative Attorney

p o ccc

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APPENDIX H

ARBITRATION

9 § 1

§ 1. "Maritime transactions" and "commerce" defined; exceptions to operation of title

"Maritime transactions", as herein defined, means charter parties, bills of lading of water carriers, agreements relating to wharfage, supplies furnished vessels or repairs to vessels, collisions, or any other matters in foreign commerce which, if the subject of controversy, would be embraced within admiralty jurisdiction; "commerce", as herein defined, means commerce among the several States or with foreign nations, or in any Territory of the United States or in the District of Columbia, or between any such Territory and another, or between any such Territory and any State or foreign nation, or between the District of Columbia and any State or Territory or foreign nation, but nothing herein contained shall apply to contracts of employment of seamen, railroad employees, or any other class of workers engaged in foreign or interstate commerce.

July 30, 1947, c. 392, 61 Stat. 670.

§ 2. Validity, irrevocability, and enforcement of agreements to arbitrate

A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

July 30, 1947, c. 392, 61 Stat. 670.

§ 3. Stay of proceedings where issue therein referable to arbitration

If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

July 30, 1947, c. 392, 61 Stat. 670.

§ 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under Title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration

agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default, or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

July 30, 1947, c. 392, 61 Stat. 671; Sept. 3, 1954, c. 1263, § 19, 68 Stat. 1233.

APPENDIX I

SUPREME COURT NO._____

IN THE SUPREME COURT
OF THE STATE OF ILLINOIS

EMILY DISTAJO, RENATO DISTAJO, CONSTATINO LAMANDO, MILO LAMANDO, JOSE ALBERTO BRENES, ALVARO GUERRERO, MARIA T. GUERRERO, WESAN S. YOUMARAN, LINDA YOUMARAN, JULIE SHINO, JOHNSON SHINO, ALBERT YONAN, LEYLAH YONAN, LOUIS LOENNEKE, MARY ANN BOOKOUT, RONALD ROTHMUND, PATRICIA ROTHMUND, JOHN S. PAPALEO and J.S.P., Inc. Plaintiffs-Movants, v. DOCTOR'S ASSOCIATES, INC., et al., Defendant-Respondent, *and* SANDRA BICKEL AND RAYMOND BICKEL, Plaintiffs-Movants, v. DOCTOR'S ASSOCIATES, INC., et al., Defendant-Respondent,	Arising out of the following cases in the Third Judicial Circuit, Madison County, Illinois: Cause Nos. 93-L-1293, 93-L-1294, 93-L-1295, 93-L-1296, 93-L-1297, 94-L-155, 94-L-799, 94-L-765 (Consolidated for pre-trial motion purposes) The Honorable P. J. O'Neill, Circuit Judge Presiding Arising out of Cause No. 94-L-1428 pending in the Circuit Court for the Third Judicial Circuit, Madison County Illinois. The Hon. Phillip J. Kardis, Circuit Judge Presiding

and

DONALD A. STUART, MARTIN SCHWARZE and D.A. STUART ENTERPRISES, INC.,

Plaintiffs-Movants,

v.

DOCTOR'S ASSOCIATES, INC., et al.,

Defendant-Respondent.

Arising out of Cause No. 95-L-1050 pending in the Circuit Court for the Third Judicial Circuit, Madison County, Illinois.

The Honorable P. J. O'Neill, Circuit Judge Presiding

MOTION OF PLAINTIFFS-MOVANTS FOR A SUPERVISORY ORDER PURSUANT TO ILLINOIS SUPREME COURT RULE 383

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ATTORNEYS FOR PLAINTIFFS-MOVANTS

SUPREME COURT NO._____

IN THE SUPREME COURT
OF THE STATE OF ILLINOIS

EMILY DISTAJO, RENATO DISTAJO, CONSTATINO LAMANDO, MILO LAMANDO, JOSE ALBERTO BRENES, ALVARO GUERRERO, MARIA T. GUERRERO, WESAN S. YOUMARAN, LINDA YOUMARAN, JULIE SHINO, JOHNSON SHINO, ALBERT YONAN, LEYLAH YONAN, LOUIS LOENNEKE, MARY ANN BOOKOUT, RONALD ROTHMUND, PATRICIA ROTHMUND, JOHN S. PAPALEO and J.S.P., Inc. Plaintiffs-Movants, v. DOCTOR'S ASSOCIATES, INC., et al., Defendant-Respondent, *and* SANDRA BICKEL AND RAYMOND BICKEL, Plaintiffs-Movants, v. DOCTOR'S ASSOCIATES, INC., et al., Defendant-Respondent,	Arising out of the following cases in the Third Judicial Circuit, Madison County, Illinois: Cause Nos. 93-L-1293, 93-L-1294, 93-L-1295, 93-L-1296, 93-L-1297, 94-L-155, 94-L-799, 94-L-765 (Consolidated for pre-trial motion purposes) The Honorable P. J. O'Neill, Circuit Judge Presiding Arising out of Cause No. 94-L-1428 pending in the Circuit Court for the Third Judicial Circuit, Madison County Illinois. The Hon. Phillip J. Kardis, Circuit Judge Presiding

and	)
DONALD A. STUART, MARTIN SCHWARZE and D.A. STUART ENTERPRISES, INC.,	) Arising out of Cause No. 95-L-1050 pending in the Circuit Court for the Third Judicial Circuit, Madison County, Illinois.
Plaintiffs-Movants,	)
v.	)
DOCTOR'S ASSOCIATES, INC., et al.,	) The Honorable P. J. O'Neill, Circuit Judge Presiding
Defendant-Respondent.	)

MOTION OF PLAINTIFFS-MOVANTS FOR A SUPERVISORY ORDER PURSUANT TO ILLINOIS SUPREME COURT RULE 383 AND SUGGESTIONS OF LAW IN SUPPORT

Come now Plaintiffs-Movants, and move the Court for entry of a supervisory order prohibiting Doctor's Associates, Inc. from relitigating the issues of the validity and enforceability of the arbitration clauses in the respective franchise agreements, under the doctrines of res judicata and preclusion, under Illinois law, until and unless the Illinois trial court judgments in favor of Plaintiffs on this issues are reversed or set aside pursuant to post-judgment motions and/or any appeals, on the following grounds:

MOTION

1. Each of the ten groups of Plaintiffs entered into franchise agreements with Doctor's Associates, Inc., the national franchisor for Subway Sandwich Shops.

2. Each franchise agreement contains an arbitration clause requiring arbitration of all disputes in Connecticut.

3. Each Plaintiff operates, or previously operated, a Subway franchise shop within the state of Illinois.

4. Each Plaintiff filed a complaint in Madison County, Illinois, against Doctor's Associates, Inc., its development agents, leasing companies and owners, alleging fraud, breach

of contract, violation of the Illinois Franchise Disclosure Act and related claims.

5. In each case, after the Plaintiffs filed their respective Illinois state court lawsuits, Doctor's Associates, Inc. filed a complaint in the United States District Court of Connecticut, against each Plaintiff in Illinois, to compel the Illinois Plaintiffs-Connecticut Defendants-franchisees to arbitrate their claims against Doctor's Associates, Inc. in Connecticut pursuant to Section 4 of the Federal Arbitration Act, 9 U.S.C. § 4.

6. The Federal Arbitration Act does not confer independent federal jurisdiction.

7. The State and Federal courts have concurrent jurisdiction of actions under the Federal Arbitration Act.

8. Under current law, State court and Federal court actions between the same parties concerning the same issues may proceed simultaneously until one enters a binding judgment, which is then binding on the same parties in the other, parallel, case.

9. In the first eight Madison County, Illinois cases, the Circuit Court entered summary judgment in favor of the Plaintiffs, pursuant to Illinois Supreme Court Rule 304(a), on October 24, 1994. That summary judgment declared the respective arbitration clauses to be void and unenforceable for several alternative reasons including waiver, lack of mutuality and unconscionability.

10. A copy of that Illinois judgment is included in the Appendix as Exhibit A.

11. Doctor's Associates, Inc. filed a motion for reconsideration of the Madison County judgment of October 24, 1994. The motion for reconsideration was scheduled for hearing on November 23, 1994. On November 22, 1994, Doctor's Associates, Inc. filed a motion for a temporary restraining order and a petition for a preliminary injunction in the United States District Court of Connecticut, and the Connecticut District

Court entered the requested temporary restraining order. As a result Doctor's Associates, Inc.'s motion for reconsideration scheduled for hearing in Madison County, Illinois on November 23, 1994 was not heard, and remains pending. On December 9, 1994 the Connecticut District Court issued the preliminary injunction requested by Doctor's Associates, Inc. which remained in effect until the September 12, 1995 opinion of the Second Circuit Court of Appeals.

12. The first eight groups of Illinois Plaintiffs then argued in the Connecticut District Court that the prior Illinois state court judgment in their favor was entitled to full faith and credit under 28 U.S.C. § 1738 because, under the law of Illinois, Doctor's Associates, Inc. would be precluded from relitigating the issues of the enforceability and validity of the arbitration clauses until and unless the Illinois state court judgment was reversed or set aside by post-judgment motion and/or appeal.

13. On November 10, 1994 the Connecticut District Court entered orders compelling the first eight Illinois Plaintiffs to arbitrate their claims against Doctor's Associates, Inc. in Connecticut.

14. On December 9, 1994, the Connecticut District Court entered the above described preliminary injunction, enjoining the first eight groups of Plaintiffs/franchisees from continuing to litigate their Illinois lawsuits against Doctor's Associates, Inc., et al.

15. The ninth group of Plaintiffs/franchisees, the Bickels, filed a complaint against Doctor's Associates, Inc., et al., in Madison County, Illinois during December, 1994.

16. Doctor's Associates, Inc. immediately filed a lawsuit in the District Court of Connecticut to compel the Bickels to arbitrate their claims against it in Connecticut, pursuant to the Federal Arbitration Act, and immediately sought a preliminary injunction enjoining the Bickels from prosecuting their Illinois state court lawsuit.

17. Doctor's Associates, Inc. and its Illinois development agent, Subway Development of Chicagoland, Inc., each failed to enter their appearance, timely, in the Madison County, Illinois lawsuit.

18. On February 7, 1995, the Circuit Court of Madison County, Illinois entered a default judgment against Doctor's Associates, Inc. and Subway Development of Chicagoland, Inc. on the issue of liability, and scheduled a damage hearing for April 4, 1995. The court also entered a default judgment against Doctor's Associates, Inc. and Subway Development of Chicagoland, Inc. on Count IV of the Complaint for a Declaratory Judgment that the arbitration clause was void and unenforceable, and declared the arbitration clause to be void and unenforceable because it lacked mutuality, was unconscionable and did not meet the reasonable expectations of the parties under Restatement of Contracts, Second § 211. That default judgment, with respect to the issue of enforceability of the arbitration clause, was issued pursuant to Illinois Supreme Court Rule 304(a).

19. A copy of that judgment is included in the Appendix as Exhibit B.

20. The Bickels filed a copy of that judgment with the Connecticut District Court, arguing that it was entitled to full faith and credit under 28 U.S.C. § 1738.

21. Six days later, on February 13, 1995, the Connecticut District Court entered orders compelling the Bickels to arbitrate their claims against Doctor's Associates, Inc. in Connecticut and enjoining them from further prosecution of their Madison County, Illinois lawsuit. The injunction contained an exception that Doctor' Associates, Inc. could move the Madison County, Illinois Circuit Court to set aside the default judgment.

22. After February 13, 1995, Doctor's Associates, Inc. filed a motion to set aside the February 7, 1995 default judgment against it, in Madison County, Illinois. That motion was briefed by both sides, and each side presented oral argument

on April 4, 1995. That motion is currently under submission to the Madison County Circuit Court.

23. During the spring of 1995, Donald Stuart, Martin Schwarze and D.A. Stuart Enterprises, Inc. filed a complaint against Doctor's Associates, Inc., et al. in Madison County, Illinois, alleging fraud, violation of the Illinois Consumer Protection Act, breach of contract and violation of the Illinois Franchise Disclosure Act, among other claims, and also alleging that the arbitration clauses in the franchise agreements were unenforceable for several, alternative, reasons.

24. Thereafter Doctor's Associates, Inc. filed a complaint in the United States District Court for Connecticut to compel Donald Stuart, et al. to arbitrate their claims against Doctor's Associates, Inc. in Connecticut pursuant to the Federal Arbitration Act.

25. On July 21, 1995 the Madison County Circuit Court entered a judgment pursuant to the motion for summary judgment of Donald A. Stuart, et al. on their count for a declaratory judgment that the arbitration clause was void and unenforceable, declaring the arbitration clauses to be void and unenforceable for several, alternative, reasons, including lack of mutuality, unconscionability and failure to meet the reasonable expectations of the parties under Restatement of Contracts, Second § 211. That judgment was also entered under Illinois Supreme Court Rule 304(a).

26. A copy of that Madison County judgment is included in the Appendix as Exhibit C.

27. On July 27, 1995, and thereafter, the United States District Court for Connecticut entered a series of orders, rulings and judgments, ordering Donald Stuart and Martin Schwarze to arbitrate their complaints against Doctor's Associates, Inc. in Connecticut and enjoining them from further prosecution of their Madison County, Illinois lawsuit.

28. All ten groups of Illinois Plaintiffs/franchisees appealed the orders and judgment of the Connecticut District

Court to the United States Court of Appeals for Second Circuit.

29. The appeals of the first eight groups of Illinois Plaintiffs (Distajo, et al.) and the Bickels (two appeals) were heard in tandem by the Second Circuit Court of Appeals which issued its opinion on September 12, 1995. The Distajo appeal also included the appeals of five Subway franchisees from Alabama, one Subway franchisee from North Carolina, one Subway franchisee from Massachusetts and one Subway franchisee from Pennsylvania.

30. A copy of that opinion is set forth in the Appendix as Exhibit D.

31. The Second Circuit Court of Appeals reversed the Connecticut District Court on all nine orders compelling the first nine groups of Illinois franchisees (Distajo, et al. and Bickel) to arbitrate their disputes in Connecticut and also reversed all nine injunctions enjoining the first nine groups of Illinois Plaintiffs from prosecuting their Illinois State Court lawsuits and remanded those cases to the Connecticut District Court for further findings of fact on the fraud, waiver and alter-ego issues with respect to the enforceability and/or validity of the arbitration clauses.

32. On the full faith and credit issue, the Second Circuit ordered the Connecticut District Court to dismiss the Petition to Compel Arbitration against one on the five groups of Alabama franchisees, John McCrary (see Exhibit D at pages 14-20).

33. The Second Circuit, however, ruled that the prior Illinois state court judgments were not entitled to full faith and credit under 28 U.S.C. § 1738. See Exhibit D at pages 20-22.

34. The Second Circuit Court of Appeals was required to interpret and apply Illinois law to determine whether, under the law of Illinois, the prior Illinois judgments entered under Illinois Supreme Court Rule 304(a) would have preclusive effect, barring Doctor's Associates, Inc. from relitigating the

issues of the enforceability and/or validity of the arbitration clauses.

35. The Second Circuit Court of Appeals concluded that Illinois law would not bar Doctor's Associates, Inc. from relitigating the issues of the enforceability of the arbitration clauses until after all appeals, in Illinois, were exhausted.

36. Plaintiffs-movants submit that the Illinois common law and an Illinois Statute each would preclude Doctor's Associates, Inc. from relitigating the issues of the enforceability and validity of the arbitration clauses until and unless the Illinois trial court judgments, entered under Illinois Supreme Court Rule 304(a), are reversed or set aside pursuant to post-judgment motion and/or appeal, and that the Second Circuit Court of Appeals simply overlooked or misinterpreted Illinois law.

37. 28 U.S.C. § 1738 requires the Connecticut District Court, and the Second Circuit Court of Appeals, to give full faith and credit to the Illinois state court judgments at issue here if, under the law of Illinois, those judgments would have preclusive effect, preventing Doctor's Associates, Inc. from relitigating the issues decided in Illinois, until and unless those judgments are reversed by post-judgment motion and/or appeal.

38. On the other hand, if those Illinois trial court judgments would not have preclusive effect under the law of Illinois, the Connecticut District Court and the Second Circuit Court of Appeals are not required to give full faith and credit to the Illinois trial court judgments.

39. Donald Stuart and Martin Schwarze have also appealed the decisions of the Connecticut District Court ordering them to arbitrate and enjoining them from prosecuting their Illinois lawsuit, to the Second Circuit Court of Appeals. That appeal is still pending. Briefs have not yet been filed and oral argument is not yet scheduled.

40. The first nine groups of Plaintiffs/franchisees (including the Bickels) have filed Petitions for Rehearing in

the Second Circuit Court of Appeals on the issues of their jury trial demands, their contention that the Connecticut District Court did not have subject matter jurisdiction under the Federal Arbitration Act and their contention that the prior Illinois trial court judgments would have preclusive effect in Illinois and therefore are entitled to full faith and credit.

41. A copy of the Petition for Rehearing in the Bickel appeal is included in the Appendix as Exhibit E.

42. An essentially identical Petition for Rehearing was filed in the Second Circuit Court of Appeals in the Distajo, et al. appeal.

43. Doctor's Associates, Inc. also appealed the Madison County judgment in the Donald Stuart case to the Illinois Court of Appeals for the Fifth District. Doctor's Associates, Inc. then moved for and obtained a stay of that appeal because of the Connecticut District Court injunction against Donald Stuart, et al.

44. This is not a request for an advisory opinion. If the Illinois Supreme Court grants this motion for a supervisory order and enters such order declaring that the Madison County, Illinois state court judgments do have preclusive effect in Illinois, those judgments must be given full faith and credit by the Connecticut District Court and the Second Circuit Court of Appeals.

45. If such order is entered by the Illinois Supreme Court prior to the appellate decision in the pending appeal of Donald Stuart, et al. to the Second Circuit Court of Appeals, the supervisory order will materially advance pending Illinois cases because it would permit the prior Illinois trial court decision in the Donald Stuart case to be reviewed by the Illinois Appellate and/or Supreme Court. Mr. Stuart's Subway franchise stores are located in Madison County, Illinois.

46. The requested Illinois Supreme Court supervisory order would also materially advance the pending Illinois cases involving the other nine groups of Illinois franchisees/Plaintiffs here in that, in the event the opinion of the

Second Circuit Court of Appeals stands as is, that case will be remanded to the Connecticut District Court for further proceedings. An order stating that the Illinois trial court judgments do have preclusive effect in Illinois would be binding upon the Connecticut District Court in any proceedings after remand and any subsequent additional appeals to the Second Circuit Court of Appeals.

47. A key issue in the Connecticut District Court and the Second Circuit Court of Appeals is whether, under Illinois law, the prior Illinois trial court judgments would have preclusive effect barring Doctor's Associates, Inc. from relitigating, with respect to the same Plaintiffs/franchisees, the issues of the enforceability and validity of the arbitration clauses.

48. Accordingly, an Illinois Supreme Court supervisory order declaring that those trial court judgments have preclusive effect under the law of Illinois would materially advance ten separate cases pending in the state trial courts of Illinois and one appeal pending in the Illinois State Court of Appeals for the Fifth District.

49. On the other hand, in the event this request for a supervisory order is denied on any grounds other than the Illinois trial court judgments do not have preclusive effect under Illinois law, the Plaintiffs, Illinois franchisees, will be denied the right to pursue their claims and cases in the courts of Illinois because of a misinterpretation of Illinois law by the Connecticut District Court and the Second Circuit Court of Appeals.

50. Five state court judgments have been entered finding the arbitration clauses of Doctor's Associates, Inc. void and unenforceable in twelve separate cases. One such judgment (one case) was entered in Alabama, one judgment (one case) was entered in North Carolina and three judgments (ten cases) were entered in Illinois. These decisions are consisted with prior Illinois appellate decisions on the enforceability of the arbitration clauses of Doctor's Associates, Inc. Current Illinois Supreme Court Justice Harrison wrote the opinion in *Yates v. Doctor's Associates, Inc.*, 193 Ill.App.3d 431, 549

N.E.2d 1010 (Ill. App. 1990), in which the court found that the leasing companies were nothing more than the alter-egos or agents of Doctor's Associates, Inc. and that therefore, eviction lawsuits filed by the leasing companies, to resolve issues under the franchise agreements, waived the rights of Doctor's Associates, Inc. to compel arbitration of issues raised in complaints filed by the franchisees. In another case the Illinois Court of Appeals affirmed a trial court judgment of $200,000.00 actual damages and $1,000,000.00 punitive damages in favor of the franchisee and against Doctor's Associates, Inc. in which the franchisee claimed that Doctor's Associates, Inc. fraudulently misrepresented its method of resolving disputes, among other claims. *Cox v. Doctor's Associates. Inc.*, 245 Ill.App.3d 186, 613 N.E.2d 1306 (Ill. App. 1993), Petition for leave to appeal denied, 152 Ill.2d 556 (1993), cert. denied, 114 S.Ct. 1069 (1994).

Wherefore, for these reasons, all ten groups of Plaintiffs/franchisees move the Illinois Supreme Court for a supervisory order that the prior Illinois trial court judgments entered under Illinois Supreme Court Rule 304(a) have preclusive effect, barring Doctor's Associates, Inc. from relitigating the issues of the enforceability and validity of the arbitration clauses until and unless those Illinois trial court judgments are reversed or set aside pursuant to post-judgment motions and/or appeals.

SUGGESTIONS OF LAW

The Federal Arbitration Act, 9 U.S.C. § 1 et seq., does not provide for independent Federal Court subject matter jurisdiction. The State and Federal Courts have concurrent jurisdiction over actions filed under the Federal Arbitration Act. *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 25, 74 L.Ed.2d 765, 786, 103 S.Ct. 927, Footnote 32 (1983).

State and Federal Court actions, between the same parties, on the same issues, may proceed simultaneously until a judgment is entered in one, binding the other under the principles of res judicata, collateral estoppel and/or the full faith and

credit statute. 28 U.S.C. § 1738. *McClellan v. Carland*, 217 U.S. 268, 282, 30 S.Ct. 501, 504-505, 54 L.Ed. 762 (1910); *Stanton v. Embrey*, 93 U.S. 548, 554, 23 L.Ed. 983 (1877); *University of Maryland v. Peat, Marwick, Main & Co.*, 923 F.2d 265, 275, 276 [7] (3rd Cir. 1991), after remand, and a second appeal, affirmed in part and reversed in part, on other grounds, *University of Maryland v. Peat, Marwick, Main & Co.*, 996 F.2d 1534 (3rd Cir. 1993).

All Madison County judgments at issue here were entered pursuant to Illinois Supreme Court Rule 304(a), 134 Ill.2d R. 304(a), and Illinois Supreme Court Rule 272, 134 Ill.2d R. 272. These judgments were therefore final trial court judgments for purposes of appellate review and for purposes of res judicata. *Village of Niles v. Szczesny*, 13 Ill.2d 45, 48, 147 N.E. 2d 371 (Ill. 1958); *Relph v. Board of Education*, 84 Ill.2d 436, 420 N.E.2d 147, 149, 150 [4-7] (Ill. 1981); *In re Marriage of Verdung*, 126 Ill.2d 542, 535 N.E.2d 818, 823 [7] (Ill. 1989).

Relph v. Board of Education, 84 Ill.2d 436, 420 N.E.2d 147, 149 [1-3] (Ill. 1981) specifically held:

> "(at 420 N.E.2d 149)
>
> The judgment of a court of competent jurisdiction, although it may be erroneous, is binding upon the parties *until reversed* and cannot be collaterally attacked.
>
> **********
>
> However, before the judgment can stand as a bar to subsequent to actions, under the doctrine of *res judicata* the first action must result in a *final judgment* on the merits. (Emphasis added.) * * * A judgment is final if it determines the litigation of the merits so that *if affirmed* the only thing remaining is to proceed with the execution on the judgment. *Village of Niles v. Szczesny*, (1958), 13 Ill.2d 45, 48, 147 N.E.2d 371. (Emphasis added).
>
> (at 420 N.E.2d 150)

> The *judgments of the appellate court were not final judgments* in the sense that they *did not terminate the litigation* but remanded the cases to the trial courts with directions that judgments be entered, which judgments, in turn, would be appealable to the appellate court under our constitution. The appellate court's decisions, in turn, would be subject to review by this court through petitions for leave to appeal. (73 Ill. 2d R. 315(a).) Since the judgments in these cases were still subject to the appellate process, they were not to be given *res judicata* effect. The most that can be said of the appellate court's mandate in each case is that it established *the law of the case*." (Emphasis added).

Plaintiffs-movants respectfully submit that *Relph v. Board of Education* was not intended to overrule *Harding Co. v. Harding*, 352 Ill. 417, 426[4], 186 N.E. 152 (Ill. 1933) where the Illinois Supreme Court held:

> "The doctrine of res judicata is, that a cause of action finally determined between the parties on the merits, by a court of competent jurisdiction, cannot again by litigated by new proceedings before the same or any other tribunal, *except as the judgment or decree may be brought before a court of appellate jurisdiction* for review in the manner provided by law." (Emphasis added).

The Illinois Supreme Court continued at 352 Ill. 417, 426:

> "A judgment or decree so rendered is a complete bar to any subsequent action on the same claim or cause of action, between the same parties or those in privity with them. This doctrine extends not only to the questions actually decided but to all grounds of recovery or defense which might have been presented."

The Illinois Supreme Court then distinguished defensive collateral estoppel from res judicata, 352 Ill. 417, 427, as follows:

> "When the second action between the same parties is upon a different cause of action, claim or demand, it is well settled that the judgment in the first suit operates as an estoppel only as to the point or question actually litigated and determined and not as to other matters which might have been litigated and determined."

Plaintiffs-movants respectfully submit neither *Relph v. Board of Education*, 84 Ill.2d 436, 420 N.E.2d 147 (Ill. 1981) nor *Ballweg v. City of Springfield*, 114 Ill.2d 107, 499 N.E.2d 1373 (1986) were intended to overrule the principles set forth in *Harding Co. v. Harding*.

Relph v. Board of Education involved issues which were more "law of the case" issues than res judicata. Only one lawsuit was filed by each school teacher in that case. The issue was whether an intermediate Appellate Court opinion/judgment, reversing a summary judgment in favor of the Defendant school district, barred the trial court, after remand, from considering changes in the law resulting from a subsequent Illinois Supreme Court decision in another case and whether that intermediate Appellate Court opinion/judgment barred the Plaintiff, in one of the cases, after remand, from amending her complaint to add a claim for damages.

The issue in *Ballweg v. City of Springfield* is also different than the issue presented by this motion. In *Ballweg v. Springfield*, a pleasure sailing boat pilot was injured and two passengers killed when the mast came into contact with low-hanging power lines. Two lawsuits were brought against the boat manufacturer. *Ballweg v. Springfield* was an action brought on behalf of one of the decedents. *Ogg v. City of Springfield*, 121 Ill.App.3d 25, 458 N.E.2d 1331 (Ill. App. 1984) is the related action brought on behalf of the other decedent and the surviving boat pilot. In *Ogg v. Springfield*, the jury returned a verdict in favor of that decedent's estate for

$100,000.00 and in favor of the surviving boat pilot for $175,000.00 and denied the claims for punitive damages. The appeal from *Ogg v. Springfield* was pending when *Ballweg v. Springfield* went to trial. Both cases involved the same accident.

In *Ballweg v. Springfield* the Plaintiff claimed *offensive collateral estoppel* against the boat manufacturer on the issue of liability. The trial court refused to apply collateral estoppel *offensively* because the appeal in *Ogg v. Springfield* was still pending.

In *Ballweg v. Springfield* the jury then returned a verdict for Plaintiff, against the manufacturer, for $304,388.35 in actual damages and $1,021,833.00 in punitive damages. The manufacturer appealed. The intermediate Court of Appeals reversed and remanded for a new trial. The Illinois Supreme Court granted review.

In *Ballweg v. Springfield*, the Illinois Supreme Court reversed the intermediate Court of Appeals, partially, and reinstated the jury verdict for actual damages of $304,388.35 and affirmed the Court of Appeals decision, partially, by denying the claim for punitive damages.

The *final result* in both *Ogg v. Springfield* and *Ballweg v. Springfield was the same*. Each of the three Plaintiffs recovered actual damages from the boat manufacturer but were precluded from recovering punitive damages.

Because of the Illinois Supreme Court ruling on other issues, it was not necessary for it to consider Plaintiffs' claim that the trial court erred in failing to apply the principles of offensive collateral estoppel on the issue of liability. Nevertheless, the Illinois Supreme Court did so, citing *Relph v. Board of Education* for the proposition that the trial court, in *Ballweg*, did not err in refusing to apply the principles of offensive collateral estoppel on the issue of liability because the prior judgment against the manufacturer in *Ogg v. Springfield* was still on appeal.

The Supreme Court also acknowledged that collateral estoppel is an *equitable doctrine* based upon the principles of judicial economy citing *Morris v. Union Oil Company*, 96 Ill.App.3d 148, 421 N.E.2d 278 (Ill. App. 1981).

By denying the offensive use of collateral estoppel while an appeal from the first judgment against the same Defendant was pending, under the facts of *Ballweg v. City of Springfield*, the Supreme Court did no harm to the *principles of judicial economy* because it arrived at the same decision, on other grounds, that it would have reached if it had applied the principles of offensive collateral estoppel.

Plaintiffs-movants respectfully submit that neither *Relph v. Board of Education* nor *Ballweg v. Springfield* overruled or reversed the rule set forth in *Harding Co. v. Harding*.

As stated in *Relph v. Board of Education*, and quoted above, in Illinois, the judgment of a court of competent jurisdiction, although it may be erroneous, is *binding upon the parties* until reversed and cannot be collaterally attacked.

Plaintiffs-movants respectfully submit that the District Court of Connecticut and the Second Circuit Court of Appeals misinterpreted Illinois law in concluding that a final trial court judgment, in Illinois, does not bar the same parties from relitigating the same issue in another case until all appeals of that final judgment have been exhausted. See pages 21 and 22 of the Second Circuit September 12, 1995 opinion set forth in Exhibit D of the Appendix.

Relph v. Board of Education establishes that a final trial court judgment becomes final for purposes of res judicata and for appellate review at the same time. That principle was reaffirmed, three years after *Ballweg v. City of Springfield* was decided, by the Illinois Supreme Court in *In re Marriage of Verdung*, 126 Ill.2d 542, 535 N.E.2d 818 (Ill. 1989). Under Doctor's Associates, Inc.'s interpretation of Illinois law, adopted by the United States District Court for Connecticut and by the Second Circuit Court of Appeals, a trial court judgment, in Illinois, would not become final for purposes of

appellate review, or for purposes of res judicata, until all appellate review had been exhausted. In other words, a trial court decision could not be reviewed until all review had been exhausted. Plaintiffs-movants respectfully submit that this is not the law of Illinois.

Illinois courts have applied the principles of the Restatement (Second) of Judgments, generally. See *Agriserve, Inc. v. Belden*, 268 Ill.App.3d 828, 643 N.E.2d 1193, 1194, 1195 [1-3] (Ill. App. 1994) where the court applied the principles of sections 24 and 25 of the Restatement (Second) of Judgments.

The Restatement (Second) of Judgments, § 13, Comment f (1990) provides:

> "A judgment otherwise final for purposes of the law of res judicata is not deprived of such finality by the fact that time still permits commencement of proceedings in the trial court to set aside the judgment and grant a new trial or the like, nor does the fact that a party has made such a motion render the judgment nonfinal. This is the case even when a statute or rule of court provides that the judgment cannot be executed upon or otherwise enforced during the period allowed for making such a motion and the further period until the motion if made is decided. The judgment ceases to be final if it is in fact set aside by the trial court, as it would be upon the granting of a motion for a new trial."

Plaintiffs-movants respectfully submit that the law of Illinois on res judicata and preclusion is essentially the same as Restatement (Second) of Judgments, § 13, comment f (1990). See *Harding Co. v. Harding*, *Relph v. Board of Education* and *In re Marriage of Verdung* as well as Illinois Supreme Court Rules 304(a) and 272.

Irrespective of the status of Illinois law on the *equitable doctrine* of collateral estoppel and/or the offensive use of the equitable doctrine of collateral estoppel, Plaintiffs-movants respectfully submit that Illinois law on the principles of res

judicata and/or preclusion, precludes *the parties* from relitigating an issue decided in a final trial court judgment until and unless that judgment is reversed or set aside during post-judgment motion proceedings and/or appeal.

Under the common law of Illinois, Doctor's Associates, Inc. can not relitigate the issues of the enforceability and validity of the arbitration clauses until and unless the final trial court judgments set forth in Exhibits A, B and C of the Appendix are reversed or set aside by post-judgment motion proceedings and/or appeal.

If Plaintiffs-movants are correct in their interpretation of Illinois law, the United States District Court for Connecticut and the Second Circuit Court of Appeals were required to give full faith and credit to those Illinois judgments under 28 U.S.C. § 1738.

Plaintiffs-movants further submit that the Illinois trial court final judgments set forth in Exhibits A, B and C of the Appendix have preclusive effect under Illinois law, by statute, in that Doctor's Associates, Inc. could not file another lawsuit in Illinois to relitigate those issues. 735 ILCS § 5/2-619(a)(3) requires dismissal of any subsequent lawsuit filed by Doctor's Associates, Inc. in Illinois to relitigate the issues decided in the three final trial court judgments set forth in Exhibits A, B and C of the Appendix.

This motion is brought under Illinois Supreme Court Rule 383, 134 Ill.2d R. 383.

This motion does not seek an advisory opinion which is prohibited in Illinois.

People ex. rel. partee v. Murphy, 133 Ill.2d 402, 550 N.E.2d 998, 1002 [5] (Ill. 1990) described an advisory opinion as follows:

> "As stated earlier, when it is apparent that an opinion cannot affect the result as to the parties or controversy before it, a court should not resolve the

> question merely for the sake of setting a precedent to govern future actions." (Citations omitted).

Plaintiffs-movants respectfully submit that the order they are requesting here would require the Connecticut District Court and/or Second Circuit Court of Appeals and/or United States Supreme Court to give full faith and credit to the Illinois trial court final judgments set forth in Exhibits A, B and C to the Appendix, which would permit those final judgments to be reviewed by the Appellate and/or Supreme Courts of Illinois in the normal fashion. The requested order could well determine whether these ten groups of Illinois franchisees will be entitled to litigate their pending claims in the state courts of Illinois or be required to arbitrate, at considerable expense, in Connecticut.

All Plaintiffs-movants have filed claims, in their Madison County, Illinois complaints, for violation of the Illinois Franchise Disclosure Act, 815 ILCS § 705/1 et seq. The Illinois Franchise Disclosure Act was enacted, in part, to protect franchisees from the conduct of large, national, franchisors. 815 ILCS § 705/2.

In attempting to interpret the Illinois Franchise Disclosure Act, Judge Posner of the Seventh Circuit, in *My Pie International, Inc. v. Debould, Inc.*, 687 F.2d 919, 922 [3] (7th Cir. 1982) stated:

> "Although this statute has been on the books for more than eight years, there has been virtually no judicial interpretation of it, and we must guess how the Illinois courts would resolve several novel issues under the act."

Five years later, in *Proimos v. Fair Automotive Repair, Inc.*, 808 F.2d 1273, 1276 [3] (7th Cir. 1987), Judge Easterbrook stated:

> "As we said in *My Pie*, 687 F.2d at 922, decided eight years after the passage of the Act, almost no state cases discuss the statute. Another four years have passed without a significant new case in the

> courts of Illinois on the subject. Either franchisors in Illinois are uncommonly law abiding and franchisees uncommonly placid, or *something is diverting cases away from the courts of Illinois.*"

Plaintiffs-movants respectfully submit that there are few cases, in Illinois, decided under the Illinois Franchise Disclosure Act because franchisors, almost invariably, insert arbitration clauses in their standard franchise agreements, requiring arbitration of disputes under the Illinois Franchise Disclosure Act in some distant state before arbitrators prequalified and partially selected by the American Arbitration Association. The American Arbitration Association, in turn, receives its repeat business from the franchisors, not the franchisees.

The American Arbitration Association charges filing fees as high as $5,000.00 simply for the privilege of filing a claim or counterclaim. The larger the amount claimed, the higher the filing fee. This tends to discourage the economically disadvantaged from filing large claims. The American Arbitration Association also regularly assesses processing fees which must be paid by the parties. The parties to arbitration must also pay the hourly charges of the arbitrators (typically lawyers). Illinois franchisees who are required to arbitrate in Connecticut must also pay travel and lodging expenses for themselves, their witnesses and their attorneys. A typical Subway franchisee must frequently "win" the arbitration in order to "break even". The American Arbitration Association will not permit a decision to be issued until all fees to it and the arbitrators have been paid. Arbitration before the American Arbitration Association is an extremely expensive method of resolving disputes. As a group, Subway franchisees are not sophisticated business people. A relatively low investment is required to become a Subway franchisee. Most Subway franchisees could be described as economically disadvantaged. They are usually working people who have saved or borrowed the amount needed for the initial investment. They then work, typically, in their own franchise stores.

Other courts have expressed frustration with the practice of Doctor's Associates, Inc. in requiring the franchisees to arbitrate their claims against it, before the American Arbitration Association, in Connecticut. In *Casarotto v. Lombardi and Doctor's Associates, Inc.*, 886 P.2d 931 (Mon. 1994), Justice Trieweiler, after authoring the majority 4-3 opinion, wrote a concurring opinion setting forth his personal views of this practice. See *Casarotto v. Lombardi and Doctor's Associates, Inc.*, 886 P.2d 931 at 939-941 (Mon. 1994). A copy of the three *Casarotto v. Lombardi and Doctor's Associates, Inc.* opinions are set forth in Exhibit F of the Appendix. The original Montana Supreme Court opinion was entered on December 15, 1994. On June 12, 1995 the United States Supreme Court granted certiorari and simultaneously vacated the Montana Supreme Court opinion and remanded the case for further consideration in light of *Allied-Bruce Terminix Companies, Inc. v. Dobson*. See Exhibit F and page 17 of Exhibit D in the Appendix. On August 31, 1995, Justice Trieweiler delivered the opinion of the Montana Supreme Court reissuing its original opinion. A copy of the slip opinion is included in Exhibit F of the Appendix. Further review by the United States Supreme Court is quite possible.

Plaintiffs-movants have not raised the same challenges to the enforcement of the arbitration clauses that were presented in *Casarotto v. Lombardi and Doctor's Associates Inc.* The Montana Supreme Court held that Montana's arbitration statute was not pre-empted by the Federal Arbitration Act, relying upon *Volt Information Sciences v. Board of Trustees of Leland Stanford Junior University*, 489 U.S. 468 (1989). Plaintiffs-movants do not contend that the Illinois Arbitration Act is not pre-empted by the Federal Arbitration Act. The original trial court judgment held that its decision was the same under the Illinois Arbitration Act and the Federal Arbitration Act, and therefore did not need to determine which applied. See Exhibit A of the Appendix. All of the defenses to arbitration asserted by Plaintiffs-movants are equally viable under the Federal Arbitration Act and the Illinois Arbitration Act.

Plaintiffs-movants also do not seek to change the current law on arbitration here. Plaintiffs-movants merely seek an order stating that the Illinois trial court final judgments set forth in Exhibits A, B and C of the Appendix are entitled to preclusive effect under the law of Illinois.

For the foregoing reasons, Plaintiffs-movants, respectfully move the court to issue a supervisory order that the final trial court judgments set forth in Exhibits A, B and C of the Appendix are entitled to preclusive effect under the law of Illinois and that the principles of res judicata bar Doctor's Associates, Inc. from relitigating the validity and enforceability of these arbitration clauses until and unless the Illinois trial court judgments are set aside or reversed by post-judgment motion proceeding and/or appeal.

Of Counsel:

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/s/ David M. Duree IBE # 697087
8 Deer Run
O'Fallon, Illinois 62269
(618) 624-2837

ATTORNEYS FOR PLAINTIFFS-MOVANTS

STATE OF MISSOURI)
) ss
COUNTY OF ST. LOUIS)

David M. Duree, being duly sworn upon his oath, deposes and states that the facts set forth in the above and foregoing motion for a supervisory order are true and correct and that the documents attached to the motion as Exhibits A, B, C, D, E and F of the Appendix are true and correct copies of such documents and that this affidavit is made pursuant to 735 ILCS § 5/1-109.

/s/ David M. Duree

Subscribed and sworn to before me this 29th day of September, 1995.

My Commission Expires:

/s/ Kelly O. Padgitt
Notary Public

[Seal]

NOTICE OF FILING AND PROOF OF SERVICE

The undersigned hereby certifies that the original and one copy of the Supervisory Order will be filed with the Illinois Supreme Court on Monday, October 2, 1995, and that one copy of the Supervisory Order has been served upon each Justice for the Illinois Supreme Court at the addresses set forth below, and that one copy of the Supervisory Order has also been served upon Defendant-Respondent, Doctor's Associates, Inc., by placing the same in the United States mail, postage pre-paid, and addressed to each Justice of the Illinois Supreme Court as set forth below, and addressed to, Edward Wood Dunham, as the attorney for Doctor's Associates, Inc., at the address set forth below: this 29th day of September, 1995.

/s/ David M. Duree

The Honorable Michael A. Bilandic
Chief Justice of the Supreme Court of Illinois
160 N. LaSalle Street, 20th Floor
Chicago, Illinois 60601

The Honorable Benjamin K. Miller
Justice of the Supreme Court of Illinois
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One North Old State Capitol Plaza
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ATTORNEY FOR DEFENDANT, RESPONDENT,
DOCTOR'S ASSOCIATES, INC.

APPENDIX J

SUPREME COURT OF ILLINOIS
SUPREME COURT BUILDING
SPRINGFIELD 62701

JULEANN HORNYAK
CLERK OF THE COURT
(217) 782-2035
TELECOMMUNICATIONS
DEVICE FOR THE DEAF
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FIRST DISTRICT OFFICE
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160 NO. LASALLE ST.
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DEVICE FOR THE DEAF
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October 31, 1995

Mr. David M. Duree
Reinert & Duree, P.C.
812 North Collins
Laclede's Landing
St. Louis, Missouri 63102-2174

In re: Emily Distajo et al., movants, v. Doctor's Associates, Inc., et al, respondents. No. 79878.

Dear Mr. Duree:

The following order was entered on this date in the above captioned case:

The motion by movants for a supervisory order is *denied.*

Very truly yours,

/s/ Juleann Hornyak
Clerk of the Supreme Court

JH:jmb

cc: Mr. Edward Wood Dunham

APPENDIX K

[United States District Court, District of Connecticut]

STATE OF MISSOURI)
) SS.
CITY OF ST. LOUIS)

AFFIDAVIT

I, DAVID G. LOSEMAN, being duly sworn, state:

1. I am over the age of 18 years, understand the obligation of an oath, and have personal knowledge of the facts set forth in this affidavit. I am a member in good standing of the Missouri bar and Illinois bar, and admitted to practice before the United States District Court for the Central and Southern Districts of Illinois, the United States District for the Eastern District of Missouri, and the United States Court of Federal Claims.

2. I am an attorney with the law firm of Armstrong, Teasdale, Schlafly & Davis in St. Louis, Missouri which is acting as local counsel on behalf of Doctor's Associates, Inc. ("DAI"), and other defendants in a set of six lawsuits filed in Illinois state court by present and former Subway franchisees. Plaintiffs in those actions are represented by the St. Louis firm of Reinert, Duree & Crane.

3. On Friday, July 29, 1994, I was in the Circuit Court of Madison County, Illinois with Glenn Davis, a partner with Armstrong, Teasdale, Schlafly & Davis, for a hearing on defendants' Motion to Transfer the Illinois state court actions to Cook County, Illinois on forum non conveniens grounds. David M. Duree of Reinert, Duree & Crane appeared at the hearing on behalf of the plaintiffs.

4. Mr. Duree produced at the conclusion of the hearing a Motion for Partial Summary Judgment for a declaratory judgment, which he had filed that day, and which asserted that the arbitration clause in each of the Illinois plaintiffs' franchise agreements is unenforceable. After oral argument on the

motion to transfer, Mr. Duree requested that the Court set the Motion For Partial Summary Judgment for hearing as soon as possible within a week or two.

5. In response to Mr. Duree's request, Glenn E. Davis advised the Court that because he had never received or seen the Motion for Summary Judgment, and because Wiggin & Dana is acting as lead counsel in the matter, he would need to confer with co-counsel at Wiggin & Dana before discussing a hearing date. The judge presiding over the hearing, the Hon. P.J. O'Neill, indicated that he would, at an unspecified future date, set the matter for a hearing, but would permit defendants' attorneys adequate time to review and respond to the motion and speak with co-counsel.

6. In response to Judge O'Neill's comments, Mr. Duree stated, in words or substance, that his clients were in a "race to the courthouse" and that he needed to set his motion as quickly as possible in order to obtain a ruling before the Connecticut District Court could rule on DAI's petitions to compel arbitration. Mr. Duree also advised Judge O'Neill that the Motion for Partial Summary Judgment should be set quickly because the arbitrability question was not based on factual issues, but only questions of law.

FURTHER AFFIANT SAYETH NOT.

/s/ David G. Loseman

Subscribed and sworn to before me, a Notary Public, this 5th day of August, 1994.

/s/ Karen S. Newell
Notary Public

My Commission expires:

[Seal]

(6) No. 95-1086

Supreme Court, U.S.
FILED
MAR 27 1996
CLERK

IN THE

SUPREME COURT OF THE UNITED STATES

October Term, 1995

EMILY DISTAJO, et al.,

Petitioners,

v.

DOCTOR'S ASSOCIATES, INC.,

Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Second Circuit

---

REPLY BRIEF OF PETITIONERS

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Counsel for Petitioners

*Counsel of Record

16 pp

QUESTIONS PRESENTED FOR REVIEW

(1) Whether 9 U.S.C. § 4 confers subject matter jurisdiction of petitions to compel arbitration upon United States District Courts which do not, and could not, have subject matter jurisdiction of the underlying state court lawsuits raising the issues to be arbitrated.

(2) Whether Illinois law permits relitigation of the enforceability and validity of the arbitration clauses while post-trial motions and/or appeals are pending from the prior nine Illinois trial court final judgments holding the arbitration clauses void and unenforceable.

(3) Whether North Carolina law permits relitigation of the enforceability and validity of the arbitration clause while DAI appeals the prior North Carolina state trial court orders denying DAI's motion to stay

under 9 U.S.C. § 3 and denying DAI's motion to dismiss based upon the contention that the arbitration clause required arbitration as a condition precedent to litigation.

(4) Whether the rule of *Moses H. Cone Memorial Hosp. v. Mercury Constr. Corp.*, 460 U.S. 1 (1983) required the Federal Courts to abstain from exercising subject matter jurisdiction of the petitions to compel arbitration, in view of the prior nine Illinois, one Alabama, and one North Carolina state trial court judgments holding the arbitration clauses void and unenforceable.

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REPLY POINTS

(1) The Illinois Supreme Court has recently, clearly, confirmed that the Doctrine of Res Judicata applies to bar parties from re-litigating claims and issues decided by a trial court judgment, before appellate review has been exhausted, thereby requiring the federal courts to give full faith and credit to the prior, nine, Illinois trial court judgments holding the arbitration clauses void and unenforceable.

Petitioners submit that *Relph v. Board of Education*, 84 Ill. 2d 436, 420 N.E. 2d 147 (Ill. 1981) and *Ballweg v. City of Springfield*, 114 Ill. 2d 107, 499 N.E. 2d 1373 (Ill. 1986) are factually distinguishable and did not reverse or overrule *Harding Company v. Harding*, 352 Ill. 417, 426[4], 186 N.E. 152 (Ill. 1933), which holds:

"The doctrine of res judicata is,

> that a cause of action finally determined between the parties on the merits, by a court of competent jurisdiction, cannot again be litigated by new proceedings before the same or any other tribunal, *except as the judgment or decree may be brought before a court of appellate jurisdiction for review* in the manner provided by law." (Emphasis added).

Petitioners' argument is set forth more fully at Pages A-78-85 of the Appendix of Respondent, DAI.

DAI argues to this court that the Illinois Supreme Court's October 31, 1995 Order (DAI Appendix at A-93) denying Petitioners' September 29, 1995 (DAI Appendix at A-91) Motion for a Supervisory Order under Illinois Supreme Court Rule 383 (DAI Appendix at A-66-92) indicates that the Illinois Supreme Court agrees with DAI's interpretation of Illinois law on the issues of res judicata and preclusion.

That argument is incorrect.

Supervisory orders under Illinois Supreme Court Rule 383 are addressed to the discretion of the Court. The denial of a Motion for a Supervisory Order has no precedential value.

Since denying the Petition for a Supervisory Order on October 31, 1995 (DAI Appendix at Page A-93), the Illinois Supreme Court has cited *Harding Co. v. Harding*, 352 Ill. 417, 186 N.E. 152 (Ill. 1933) with approval, *Herzog v. Lexington Township*, 167 Ill. 2d 288, 657 N.E. 2d 926, 930 [2] (Ill. 1995), and has specifically ruled, on March 21, 1996, that a trial court judgment operates as a final judgment on the merits for purposes of res judicata, notwithstanding a subsequent appeal. See *Rein v. Noyes and Co.*, Illinois Supreme Court Case No. 79168, March 21, 1996 slip opinion at Page 8:

> "Therefore, under Rule 273, the trial judge's decision to grant defendants' Motion to Dismiss the Rescission counts in *Rein I* based on the applicable statute of limitations is a final adjudication on the merits and operates as a final judgment on the merits for purposes of res judicata." (Emphasis added).

The decision of the Illinois Supreme Court in *Rein v. Noyes and Co.*, is consistent with *Harding Co. v. Harding*, 352 Ill. 417, 426 [4], 186 N.E. 152 (Ill. 1933), which has never been reversed.

Relph v. Board of Education and *Ballweg v. City of Springfield* are factually distinguishable. Neither case involved an attempt by a losing party to re-litigate the same claims and issues that it just lost against the same opposing party, while appealing the adverse decision from the first case.

Neither the Connecticut District Court, nor the Second Circuit Court of

Appeals nor DAI in its Brief in Opposition before this court have discussed *Harding Co. v. Harding* or the Illinois Statute which would bar DAI from re-filing, in Illinois, another lawsuit raising the same claims that were decided adversely to it in the nine prior decisions holding the arbitration clauses void and unenforceable. See 735 ILCS §5/2-619(a)(3) and (b).

The Illinois Petitioners have been denied the full faith and credit required by 28 U.S.C. § 1738 for their prior Illinois State Court judgments holding the arbitration clauses void and unenforceable because of a misinterpretation of Illinois law by DAI, the Connecticut District Court and the Second Circuit Court of Appeals.

(2) In the alternative, the *Rooker-Feldman Doctrine* denies subject matter

jurisdiction to DAI's federal court Petitions to Compel Arbitration since the state courts of Illinois and North Carolina have entered prior judgments holding the arbitration clauses void and unenforceable.

The Connecticut District Court Petition to Compel Arbitration against Michael Johnson, the North Carolina franchisee, was not filed until May, 1994. At that time Michael Johnson's state court lawsuit had been pending in North Carolina for more than one year and the North Carolina trial court had entered appealable orders denying DAI's Motion to Stay that litigation under 9 U.S.C. §3 and denying DAI's Motion to Dismiss that lawsuit. Contemporaneously with filing the Connecticut federal court Petition to Compel Arbitration against Michael Johnson, DAI filed its Notice of

Appeal to the North Carolina Court of Appeals.

In five of the first six Illinois state court cases, DAI filed Motions to Stay those lawsuits under 9 U.S.C. §3, then withdrew those motions before the state court could rule, in favor of filing its Petitions to Compel Arbitration in the Connecticut District Court under 9 U.S.C. §4.

In all of the Illinois cases at issue here, the Illinois trial court entered final trial court judgments holding the arbitration clauses void and unenforceable before the Connecticut District Court entered orders compelling arbitration.

The *Rooker-Feldman Doctrine* is based upon *Rooker v. Fidelity Trust Co.*, 263 U.S. 413, 44 S. Ct. 149, 68 L.ed. 362 (1923) and *District of Columbia Court of*

Appeals v. Feldman, 460 U.S. 462, 103 S.Ct. 1303, 75 L.ed. 2d 206 (1983) which bar litigants from filing federal court collateral attacks on state court civil judgments even where the state court judgments could be collaterally attacked in state court proceedings. *Gash Associates v. Village of Rosemont, Ill.*, 995 F. 2d 726, 727 [1-3] (7th Cir. 1993).

Gash Associates v. Village of Rosemont, 995 F. 2d 726, 728 [4-5] (7th Cir. 1993) held that the *Rooker-Feldman Doctrine*, in contrast to the full faith and credit statute, does not require that the prior state court judgment have preclusive effect under state law, stating that the Doctrine:

> " * * * rests on the principle that district courts have only original jurisdiction; the full appellate jurisdiction over judgments of state courts in civil cases lies in the Supreme Court of the United States, and parties have only a short time

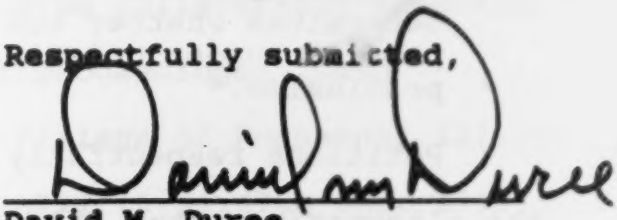
> to invoke that jurisdiction. The *Rooker-Feldman* Doctrine asks: is the federal plaintiff seeking to set aside a state judgment, or does he present some independent claim, albeit one that denies a legal conclusion that a state court has reached in a case to which he was a party? If the former, then the district court lacks jurisdiction; if the latter, then there is jurisdiction and state law determines whether the defendant prevails under principles of preclusion."

Petitions respectfully submit, in the alternative, that DAI's continued prosecution of the Connecticut District Court Petitions to Compel Arbitration, after adverse state court judgments holding the arbitration clauses void and unenforceable, can only have the effect of setting aside, or rendering moot, the adverse state court judgments, and therefore such continued prosecution of the federal court Petitions to Compel Arbitration is barred by the *Rooker-Feldman Doctrine*.

CONCLUSION

For one or more of the reasons set forth in the Petition for a Writ of Certiorari, or in this Reply Brief, the Petition for a Writ of Certiorari should be granted.

Respectfully submitted,



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